

**The Influence of Board of Directors' and
Board's Subcommittees' Attributes
on Performance: An Empirical Evaluation of
Companies Listed in KLSE.**

by

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**A Thesis Submitted to Cardiff University In Fulfilment of the Requirements for
the Degree of Doctor of Philosophy**

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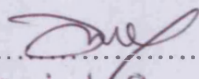
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Abstract

The purpose of this thesis was to examine the impact of the adoption of the Malaysian Code of Corporate Governance 2001 and Kuala Lumpur Stock Exchange (*presently known as Malaysia Bourse*) Listing Rulings 2001 by 221 listed Main and Second Board firms of the Bourse on their firm performance. To fulfil this objective, the study hypothesised the relationship between the firms' board of directors' and its sub-committees' (i.e. audit committee, nomination committee and remuneration committee) composition, structure and competency on firm performance. The study findings indicated that the presence of an independent director with corporate governance experience (i.e. a senior independent director) on the board of directors and its subcommittees had a positive impact on firm performance. Specifically, when domineering executive directors and family-member director(s) were present on the board and its subcommittees, the appointment of senior independent director safeguarded and strengthened the quality of independence, credibility, and influence of independent directors' views and decisions. Moreover, the board of directors that was led by an independent director, non-executive director or founder, and that had a separate chairman and CEO position established appropriate control and monitoring of authorization of power on the organisational process and board members conducts.

Further, the presence of a high proportion of independent directors on the board and its sub-committees was important to monitor family-member director and CEO, CFO and/or managing director influence on the board's and its sub-committees decisions. The study also found, the appointment of an independent financial expert, namely someone with practising accountant experience on the audit committee to be crucial given that some companies had the tendency to appoint the CEO, CFO, managing director and/or family-member director with a financial background to fulfil the position. In addition, directors with industry knowledge and experience were substantial in enhancing board entrepreneurship skills, strategic investment planning and improving the overall decision making process. The study further revealed that foreign directors and institutional investors that were active in monitoring of firm activities vital for shareholder value creation.

The findings of the thesis make several important contributions to the corporate governance literature in identifying the impact of family-member directors' membership of audit, nomination and remuneration committees on such committees' effectiveness. Further, the empirical evidence gathered will assist the policy-makers in evaluating and improving current corporate governance ruling for better protection of investors' interests and greater commitment of corporations to practise responsible corporate governance conduct.

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Abbreviations

AC	Audit Committee
BOD	Board of Director or Board
BRC	Blue Ribbon Committee
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CMMP	Capital Market Master Plan
COO	Chief operating Officer
IMF	International Monetary Fund
KLSE	Kuala Lumpur Stock Exchange
MBSB	Malaysia Bourse Securities Limited (before April 2004 it was known as KLSE)
MBTop	Top 100 Main Board Malaysian Listed Companies
MESDAQ	Malaysian Exchange of Securities Dealing and Automated Quotation
MCCG	Malaysian Code of Corporate Governance
MICG	Malaysian Institute of Corporate Governance
MSWG	Minority Shareholders Watchdog Group
NC	Nomination Committee
POB	Public Oversight Board
PwC	Pricewaterhouse Coopers Lybrand
RC	Remuneration Committee
RM	Ringgit Malaysia
SC	Securities Commission

Chapter 1

~Introduction to the Research~

1.0 Introduction to the Study

The continuance of and increase in firms' top executives' and insiders' misconduct has been heavily criticised and attributed in many studies to weaknesses in firms' corporate governance practices (see, for example, Beasley, 1996; Gomez and Sundaram, 1997; Aziz, 1998; Claessens et al., 1999; DeZoort and Salterio, 2001; Bhagat and Black, 2002; Chang Aik Leng and Abu Mansor, 2005; Dionne and Triki, 2005). Pre-emptive measures have included the recognition that strong collaborative commitments and efforts amongst market participants, notably firms, regulators, legislators, institutional bodies, shareholders and stakeholders, need to be established. In particular, these parties need to concur with each other on the purposes and objectives of good corporate governance practices because appropriate attitudes and stances are important stimuli for the enforcement of effective monitoring and controlling mechanisms in the firm (see, Parker, 2005).

It is therefore seen as relevant and important to closely examine the roles, functions and commitment of the internal governing bodies, namely, the board of directors and board subcommittees, particularly in their execution of oversight responsibilities (MBSB, 2004) since there appears to be disparity at the top management level in what constitutes the appropriate and sufficient supervision and oversight and assessment of directors' and executives' trustworthiness when managing and administering a firm's affairs. As a result, some research has been undertaken to identify the characteristics of firms that may incline them towards engaging in

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fraudulent conduct given the state of their board members' monitoring and control of activities (Sonnerfeld, 2004).

Adam Smith (1776:700) contended that the divergence between investors' and corporate officers' interests underscores the imperativeness of exercising appropriate caution, given managers' level and extent of authority in conducting a company's business activities. He specifically stated that managers' conduct requires continual monitoring and oversight because:

"...being the managers of other people's money rather than their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private co-partner frequently watch over their own...Negligence and profusion, therefore, must always prevail, more or less, in their management of the affairs of others..." (Adam Smith, The Wealth of Nations, 1776:700).

In view of his observations, independent outside director placements on the firm's board of directors is therefore deemed crucial to establish an impartial and objective oversight body within the firm that is free from management influence so its' integrity and credibility can be relied upon. For this purpose, outside such directors should not have links with the firm, whether through employment, business and/or family relations. Moreover, unless they are vigilant, committed and proactive when conducting decision making and evaluating activities, independent directors will not be effective in combating misconduct and incidents of fraud (Lee et al., 2004; Chang Aik Leng and Abu Mansor, 2005). Further, without effective corporate governance mechanisms, investors are susceptible to receiving erroneous information and may, as a consequence, lose their investments, mainly due to the absence of timely information as a

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result of their lack of control over the type and amount of information that companies decide to disseminate.

1.1 Background to the Study

For decades, many financial commentators and experts have pointed out that managers can expropriate a firm's assets when ownership and management of the business are conducted by separate individuals, due to the conflict of interests between the two respective parties (see, for example, Berle and Means, 1932; Jensen and Meckling, 1976; Fama, 1980; Demsetz and Lehn, 1985). Importantly, investors' diminishing trust in capital market conduct and supervision could affect market viability, development, expansion and competitiveness, and domestic and international finance (OECD, 1999; Malaysian Security Commission, 2001; OECD, 2002; Murray and Gray, 2006).

An improvement in the transparency of corporations' practices is imperative in the Malaysian business environment in order to restore and secure the integrity of its capital market system after the 1997 economic crisis (MEPU, 2001). Aziz (1998) has also highlighted the importance of making transparent the disposal of public assets through privatisation in Malaysia. He argues that this is crucial to ensure best governance practices have been properly implemented in private and public procurement procedures in the country and to inhibit the practice of crony capitalism. Greater transparency of firms' management will also discourage corrupt behaviour in Malaysian society (Aziz, 1998). So far, the requirement by the Securities Commission and Kuala Lumpur Stock Exchange¹ for firms to disclose the identity of previously 20 and latterly 30 of their substantial shareholders has provided clarification of the identity of these large

¹ Presently known as Malaysia Bourse Securities Limited (MBSB)

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shareholders² (who previously could have been disguised behind appointed nominees) and has enhanced investors' assessment of major shareholders' connections with and influence on firms' decision-making processes (Aziz, 1999).

In addition, the presence of high calibre, competent and credible outside independent directors on Malaysian public listed boards is imperative to inhibit the widespread practice of managers' entrenchment at the expense of minority interests, as occurred in the case of United Engineer Malaysia Berhad's (UEM) acquisition of a 32.6% stake in its troubled parent company, Renong Berhad, at a price double its current market value (Doraisami, 2005) and the Malaysian Airline Systems Berhad (MAS) chairman's exploitation of the corporation's funds to settle his personal debt (Johnson et al., 2000: 144).

Prowse (1998), Claessens et al., [1999, 1999(a) and 2000] and Mitton (2002) reported the expropriation of assets by family-controlled owners in East Asian listed firms at the expense of minority shareholders' interests was precipitated by the prevailing pyramidal firm ownership structure³ (Thillainathan, 1999; Ow-Yong and Kooi, 2000; Gugler, 2001; Johnson et al., 2001; La Porta et al., 2002; Lemmon and Lins, 2003; Almeida and Wolfenzon, 2005). Moreover, the pyramidal organisational structure further intensifies agency problems created by the separation of ownership and control, as Volpin's (2002) study detected a lower percentage of Q ratios at the bottom of the pyramidal group than the holding firm.

² This disclosure requirement is mandated in Malaysia Bourse Securities Limited (MBSB) Listing Requirements, particularly in paragraph 8.15 and under the classification of material information section in paragraph 9.03 and 9.19.

³ The control of a firm through a chain of ownership relations (see Almeida and Wolfenzon, 2005)

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Significantly, authorities and regulatory bodies, such as the Stock Exchange, the Securities Commission, the Accounting Standards Board, private organisations/institutions, and the government, operate as the external mechanism that disciplines firms' activities via guidelines and recommendations, legislation, regulations and enforcement policies (Karpoff et al., 1989; Franks and Mayer, 1990; La Porta et al., 1998; Iskander et al., 1999; OECD, 2002; Barako et al., 2006). Their governing authority allows them to dictate and prescribe the requirements for emulating and ensuring quality corporate governance practice, specifically by listing rulings with regard to the required standards of information disclosure and enforcement, the transparency and accountability of business entities' participants and imposing heavy penalties for insider trading (Laufer, 2000; Hermalin and Weisbach, 2003).

Moreover, the enactment of investors' protection legislation provides legal security and validation, especially when pursuing lawsuits on the discovery of mistreatment of investors' rights (Franks and Mayer, 1990; Schleifer and Vishny, 1997). Another measure of external monitoring is the establishment and enforcement of codes of corporate governance and best practices by firms, whether on a voluntary, hybrid or prescriptive basis. These disciplining measures inculcate, guide and/or stipulate appropriate governance practice in corporations (see, for instance, Cadbury, 1992; Combined Code, 2000; FCCG, 2001; Higgs, 2003; OECD, 2004).

As regards to the internal corporate governance mechanisms, studies continue to examine the actual role of Boards of Directors, specifically their strategic decision-making, monitoring, service, and accessing scarce and critical resources function (Pfeffer, 1972; Henn, 1974; Kosnik, 1987; Zahra and Pearce, 1989; Johnson et al., 1996; Hendry and Kiel, 2004; Van den Berghe

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and Levrau, 2004; Kor and Mahoney, 2005; Wan and Ong, 2005). Moreover, research on the functions and effectiveness of the Board of Directors and its subcommittees, notably, audit committees, nomination committees and remuneration committees, has recognised its functions as a governance instrument with delineated responsibilities and the potential to improve the quality of financial reporting [Yermack, 1997; Dalton et al., 1998; Klein, (1998, 2002); Vafeas, 1999; Carson, 2002; Van den Berghe and Levrau, 2004; Long et al., 2005; Gendron and Bedárd, 2006].

1.2 Research Objectives

In recognition of the significance of investigating the corporate governance practices of Malaysian corporations and considering them in terms of their potential effects on firms' financial viability, this thesis aims to fulfil the following research objectives:

1. To show the significance of board of directors' independence from management influence in sustaining a firm's financial performance.
2. To show the significance of the role and function of board and sub-committee chairmen in sustaining a firm's financial performance.
3. To show the significance of the board of directors' knowledge and skills in fulfilling their duties in sustaining a firm's financial performance.
4. To show the significance of the formation, composition, leadership of board committees and, where appropriate, their accounting and financial background for the fulfilment of their duties in sustaining a firm's financial performance.

1.3 Research Questions

Primarily, this thesis aims to examine the influence of Malaysian corporations' adherence to corporate governance practices as stipulated by the Malaysian Code of Corporate Governance Principles and Best Practices and the Kuala Lumpur Stock Exchange Listing Requirements 2001 on firms' financial viability. In particular, this study investigates the effect of firms' boards of directors' and board subcommittees' compliance with these stipulations on firms' financial performance.

Accordingly, the following research questions were constructed to evaluate the effects of firms' implementation of internal monitoring and control mechanisms on their financial position:

1. Does the independence of board of directors' members from management influence affect a firm's financial performance such that they
provide appropriate monitoring and control over family owner-managers' entrenchment endeavours?

are committed to and accountable in pursuing their overseeing responsibilities in the firm on shareholders' behalf?
2. Does the structure of the board of directors affect a firm's financial performance?
When the power and authorities of the CEO at the top hierarchy of management is balanced and disciplined by the designation of a separate Chairman, particularly an independent Chairman, will this reduce the CEO's unwarranted empire building and/or wealth seeking motives?

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3. Do the knowledge and skills of the board of directors' members affect a firm's financial performance?

When the board comprises members with specific accounting, finance, business-related knowledge and skill and legal background will these aspects have an influence on their performance of financial and non-financial overseeing duties?

4. Does the independence of audit committee members from management influence affect a firm's financial performance?

When audit committee members are free from an association with members of management, will the independent quorum become an effective body that can conduct an objective and appropriate evaluation of the firm's financial reporting practice and internal control procedures and hence safeguard and enhance shareholders' investments interests?

5. Does the leadership of the audit committee affect a firm's financial performance?

When the Chairman of the audit committee has prior accounting experience, will the focus and considerations of the statutory audit work plans and assignments, and subsequently the assessment of audit findings, support the external and internal auditors' recommendations for credible corporate reporting and hence safeguard and enhance shareholders' investments interests?

6. Do the accounting and financial knowledge and skills of audit committee members affect a firm's financial performance?

Being capable of overseeing accounting and/or financial issues, will the audit committee be able to comprehend clearly their financial governing duties and so make a productive contribution to the scope and discussion of the appraisal of the financial position and reporting and the state of internal control of the firm and hence safeguard and enhance shareholders' investments interests?

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7. Does the formation of nomination and remuneration committees affect a firm's financial performance?

By establishing designated committees that monitor the selection of board's candidates and oversee the arrangements for executive remuneration, will board members' objectivity and credibility in the accomplishment of their duties and the confinement of unnecessary payments to executives be assured and protected and hence contribute to firm value creation?

8. Does the independence of nomination and remuneration committee members from management influence affect a firm's financial performance?

Will the placement of non-affiliated board members in the corresponding committees enable them to reinforce firm, impartial and conscientious views (of the board's performance) when nominating suitable persons for further board effectiveness, and to execute control over inordinate executive compensation and hence contribute to firm value creation?

9. Does the structure of nomination and remuneration committees affect a firm's financial performance?

When these committees are led by independent directors, will their members' objectivity and goal of scrupulous activity in conducting their duties be assured and hence contribute to firm value creation?

1.4 Research Methodology

The current research study employed a cross-sectional research approach where the corporate governance practice and financial performance of Main and Second Board Malaysian listed firms were examined over a two year period. In addition random sampling was used to identify the sample size of Malaysian Main and Second Board listed companies to be examined in furtherance of research objectives. Financial data were gathered from Malaysian public listed

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companies' annual reports, Datastream and OSIRIS database. Data were subsequently explored and analysed using multiple regression analysis to examine and identify their statistical significance for the purposes of the study.

1.5 Motivation for the Study

The main motivation of the study is to examine the impact of firms' board of directors' and managers' adherence to the Principles of the Malaysian Code of Corporate Governance and their implementation of Best Practices have on firm performance. In view of their long-standing business traditions and customs, some family-owned enterprises, where firms' shares are significantly owned by the founders have raised their concerns about the impact of the new corporate governance code on the business perceptions of their board members since the importance of accepting certain risks in business is viewed as essential for the growth of firms (Chairman of the Securities Commission of Malaysia, 2003)⁴.

However without the implementation of appropriate and sufficient governing rules and regulations it is difficult to inhibit, control and prevent controlling owners from expropriating minority shareholders' interests in Malaysia corporation [See Claessens et al., 1999(a); Johnson et al., 2000; OECD, 2004]. Moreover, the disparity between control and cash flow rights in Malaysian corporations as a result of investors' indirect links with several associated firms (or pyramidal business links) can create incentives for investors to divert resources into the firm that gives them the greatest cash flow rights (Thillainathan, 1999). Also, family-controlled firms

⁴ Notably, the family-member board's executive director may have particular long standing business traditions and customs that may be affected with the firm's adoption of Malaysian Codes on Corporate governance (see Abdul Kadir, 2003)

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have the tendency to put the interests of the family members above shareholders' interests (Hermalin, 1991).

The current research's examination of the impact of board of directors' and board sub-committees' attributes, namely, their independence, structure and competency on firm performance will be able to ascertain the significance and effectiveness of such boards' and subcommittees' oversight of firm' activities and whether they are pursued in line with shareholders' value maximisation.

Moreover, central to the Malaysian economic crisis between mid 1997 until the last quarter of 1999 were the weaknesses in Malaysian firms' corporate governance practices. Many studies have identified these elements as one of the main causes of the country's economic suspension (for instance, the Malaysian Economic Planning Unit, 1998; Claessens et al., 1999; Iskander et al., 1999; Thillainathan, 1999; Johnson et al., 2000; Kawai, 2000). In particular, the weak monitoring and controlling measures prevailing in most Asian-concentrated ownership firms contributed to the lack of accountability of companies' owners and managers (Prowse, 1998). This left minority shareholders' interests vulnerable to expropriation by controlling interests (Claessens et al., 1998, 1999; Johnson et al., 2000). The issue of the mismanagement of funds required policymakers to take action to establish an efficient and competitive financial system (See Abdul Majid, 1998) that fairly distributed gains among borrowers, equity holders, the government and external creditors. So doing would raise investors' diminishing confidence and promote trading in the capital market (Iskander et al., 1999).

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Notably, the second objective of Malaysia's National Economic Recovery Plan⁵ was to restore market confidence. Within this objective, improvement in transparency and in the regulatory environment was made a priority (Wee, 1998: 9) to ensure investors became well informed to make appropriate investment decisions. One way of ensuring this was to regulate the information that needed to be disclosed by companies to the public as well as the frequency of such information's availability. In particular, Malaysia's Securities Commission and Stock Exchange were entrusted with enforcing strict rulings and curbing corruption in industries. Raising the level of transparency and the quality of corporate disclosures was viewed as imperative to facilitate the monitoring and controlling of large inside shareholders' activities and to prevent investors from remaining misinformed (Kawai, 2000).

The establishment of rules and policies provides systematic assurance of safety and protection within an investment platform (McKinsey, 2000). On a large scale, it affects a country's economic viability, financial stability and capital market competitiveness (La Porta et al., 1997, 1998; Maher and Andersson, 1999). Importantly, corporate governance research conducted in response to economic trouble may also help to identify specific problems and to instigate corresponding resolutions (Murphy and Topyan, 2005). Malaysian policy-makers' (i.e. members of the High Level Finance Committee and Working Groups on Best Practices of Corporate Governance) establishment of the Malaysian Code of Corporate Governance indicated their immediate response and recognition of the need to enforce good corporate governance practices in Malaysian corporations. Hence, the current's examination of Malaysian firms' adoption of Corporate Governance Principles and Best Practices in their board of directors' and board

⁵ This comprehensive plan was prepared by Malaysia's National Economic Action Council (NEAC) [in collaboration with other governmental institutions, private organisations, professional associations, industry participants, World Bank, IMF and non-governmental organisations] in 1998 to make recommendations to the Government in respect of restoring the economy and preventing further recession.

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subcommittees' composition, structure and characteristics will provide empirical evidence of their effectiveness in terms of firm performance and whether policy makers' corporate governance initiatives have been sufficient or need to be extended further.

The presence of independent non-executive directors and/or non executive directors on listed companies' board of directors in Malaysia is imperative because the majority of these companies are individual and/or family owned (Thillainathan, 1999; Claessens et al., 1999 (a), (b), (c), (d) and 2001; Johnson et al., 2000; and Ow-Yong and Kooi Guan, 2003) and the owners or families are also members of the board of directors. In order to provide a check and balance of power in the decision-making process at the board of directors level, the role and presence of a certain number of independent non-executive directors and non-executive directors on the board become important. In addition,

An owner manager has greater discretion than a non-owner/manager because the legal and moral case for an unusual application of corporate resources is greater for the former and because the owner-manager's control position is likely to be more secure

(Herman, 1981:247)

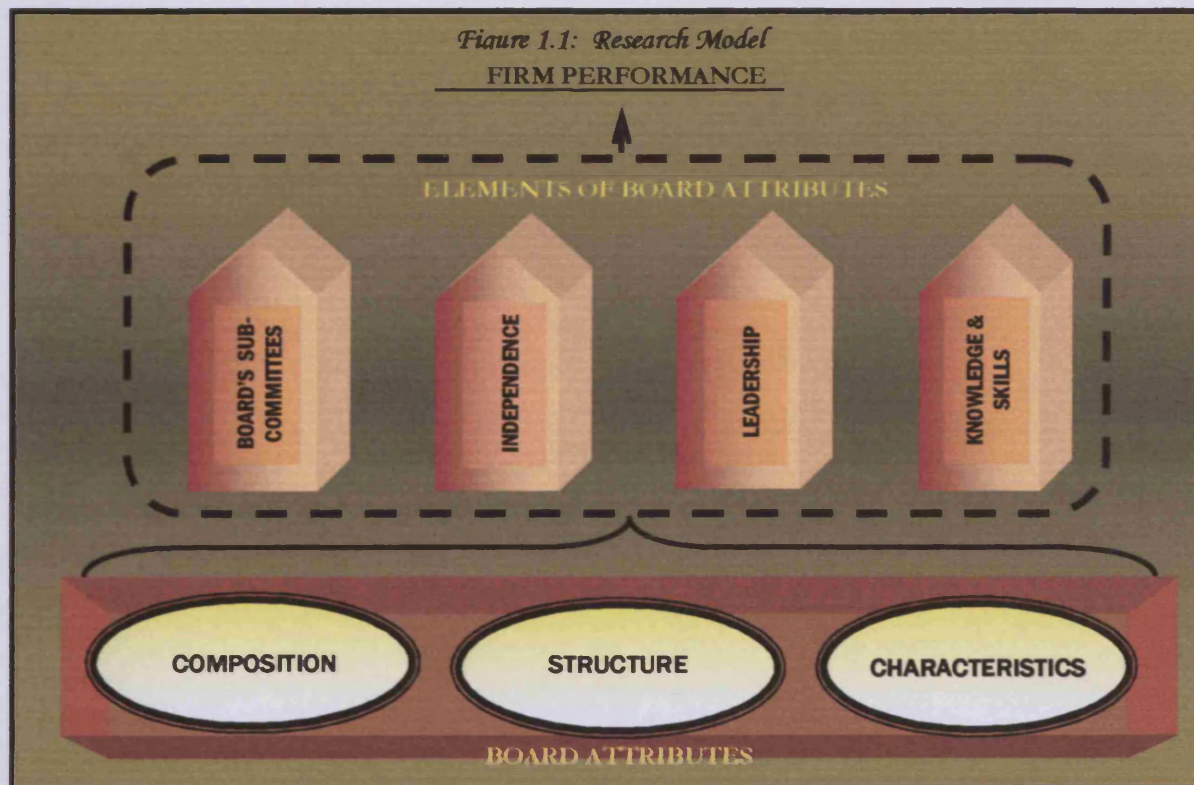
There have been several studies researching the effect on firm performance of establishing board committees. The number of studies on the role and importance of audit committees is immense and continues to grow and the number of studies on the role of other board committees, such as nomination and remuneration committees, is also increasing. The formation of board committees can be seen as a delegation of duties of the board of directors for the improved control and monitoring of the efficiency of board of directors' tasks.

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In addition, the compliance of many Malaysian corporations with the Principles and Best Practices of Corporate Governance does not necessarily indicate their enforcement of the guidelines' true meaning or of the substance of the Code, demonstrating the importance of examining the implications of firms' adherence to the Code of Corporate Governance by measuring their efforts in value deliverance in terms of firm value.

1.6 Scope of the Study

The aim of this thesis is to examine the association between a given set of corporate governance control and monitoring mechanisms and firm performance. The model of this research concentrates on the elements of firms' internal monitoring and control mechanisms in its examination of the impact of firm governance practices on firm performance. Their relationships are presented in Figure 1.1.



1.7 Outline of the Thesis

As noted in previous sections, the core aims of the research are to examine corporate governance mechanisms, board of directors' and board committees' attributes, role and contribution in improving firm performance and evaluating Malaysian business practices. Chapters 2 - 4 review the literature pertaining to these elements.

Chapter 2 provides an overview of Malaysia's business environment, economic history and development. In particular, the chapter deliberates on the Malaysian financial and capital market regulatory environment, namely, regulatory bodies' functions in monitoring and establishing corporate accountability in Malaysian industries' activities and in promoting Malaysia as a potential investment platform. Further, the chapter discusses corporate governance initiatives and development by regulatory bodies and private organisations.

Chapter 3 examines several corporate governance theories that have been adopted in relation to the roles, functions and contribution of boards of directors to firm performance. Theories include the Legalistic view, Resource Dependency view, Agency theory, Managerial-Class Hegemony theory, Stakeholder theory and Stewardship theory.

Chapter 4 focuses on the roles of the Board of Directors and examines board attributes, namely, composition, structure, characteristics and processes, and their respective implications for fulfilment of the board's duties. In addition, the role and functions of the board's subcommittees, notably, audit, nomination and remuneration committees, are examined individually. The chapter then discusses market value and accounting-based measures of

CHAPTER 1: INTRODUCTION TO THE RESEARCH

financial performance. In addition founder-family presence and firm ownership structure are discussed to identify their impact on the board's and its sub-committees' performance of oversight duties and hence firm performance.

Chapter 5 presents the research hypotheses and research models established to test the research's propositions regarding the impact of board of directors' and its subcommittees' independence, structure and characteristics on firm performance.

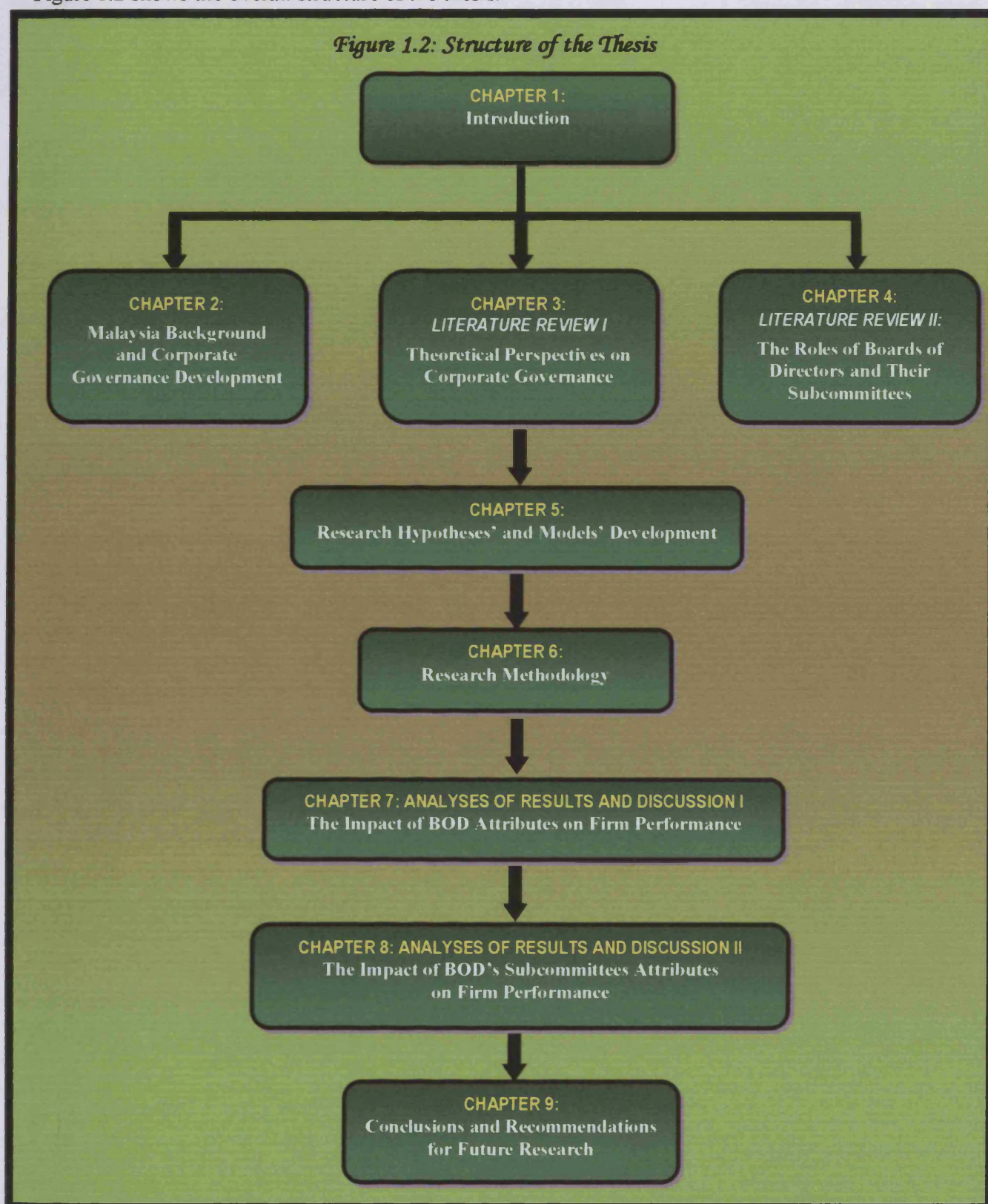
The research design, sampling techniques, data sources and types of data collected by the researcher for implementation of the current study are discussed in Chapter 6. The chapter also describes the research models' variables, namely, independent, explanatory and control variables and their characteristics. The chapter also details the research data analysis technique, primarily multiple regression analysis, focusing on its assumptions and the suitability of the research models' parameters for examination using this technique.

Chapter 7 and 8 present the analysis and discussion of the impact of board of directors' and its sub-committees' attributes on firm performance, respectively. The results are elaborated upon to link them with previous research findings.

Chapter 9 summarises the overall findings derived from the research and suggests areas for future extension of this study.

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Figure 1.2 shows the overall structure of the thesis.



CHAPTER 1: INTRODUCTION TO THE RESEARCH

1.8 Conclusion

This chapter has provided an introduction to the study, explained the research objectives, presented the research questions, and briefly detailed the research methodology, motivations and scope of the study. It has also outlined and summarised succeeding chapters. The next chapter will focus on the economic background and development of corporate governance in Malaysia.

Chapter 2

~Malaysia Background and Corporate Governance Development~

2.0 Introduction

Chapter 1 presented an overview of the research framework and design. This chapter details Malaysia's business environment, economic history and development and capital market. The initiatives and involvement of regulatory bodies, private institutions and professional bodies in the development of corporate governance rules and regulations are then considered. A discussion of the subsequent adoption and enforcement of these directives by Malaysian public listed companies subsequently follows. The elements and subjects reviewed provide insight into Malaysia's adaptation of its governance practices to international norms and endorsements of stipulated corporate governance good practices.

2.1 Malaysia's Economic History and Overview

The Malaysian economy continued to prosper from the 1960s to the late 1990s. Initially, the economy was concentrated on agricultural and mining activities, particularly rubber and tin, which accounted for 70% of total export earnings (Malaysia Economic Planning Unit, 2006). Private sector investment was the main economic driver, with an annual growth rate of 7.3%. In addition, the economy also relied on foreign trade to finance its economic development. Among the Malaysian government's objectives was the eradication of rural poverty. In response, the modernisation of agricultural production was initiated, together with the promotion of industrial development with the implementation of an import substitution strategy. Such development provided a stronger economic base for Malaysia since it encompassed agricultural,

CHAPTER 2: MALAYSIA BACKGROUND AND CORPORATE GOVERNANCE DEVELOPMENT

manufacturing, utilities and services sectors. Timber and palm oil also emerged as significant new export commodities.

Later, in the 1970s, the economy diversified into export-oriented manufacturing industries, specifically, the production of textiles, electrical and electronic goods, and rubber products. Malaysia's economic growth during the 1970s and 1980s was the result of the booming oil and natural gas industries. Table 2.1 presents the list of economic development plans that have been undertaken by the government prior to Malaysia Independence and post independence⁶.

Table 2.1: An Overview of Malaysian Economic Development Plans

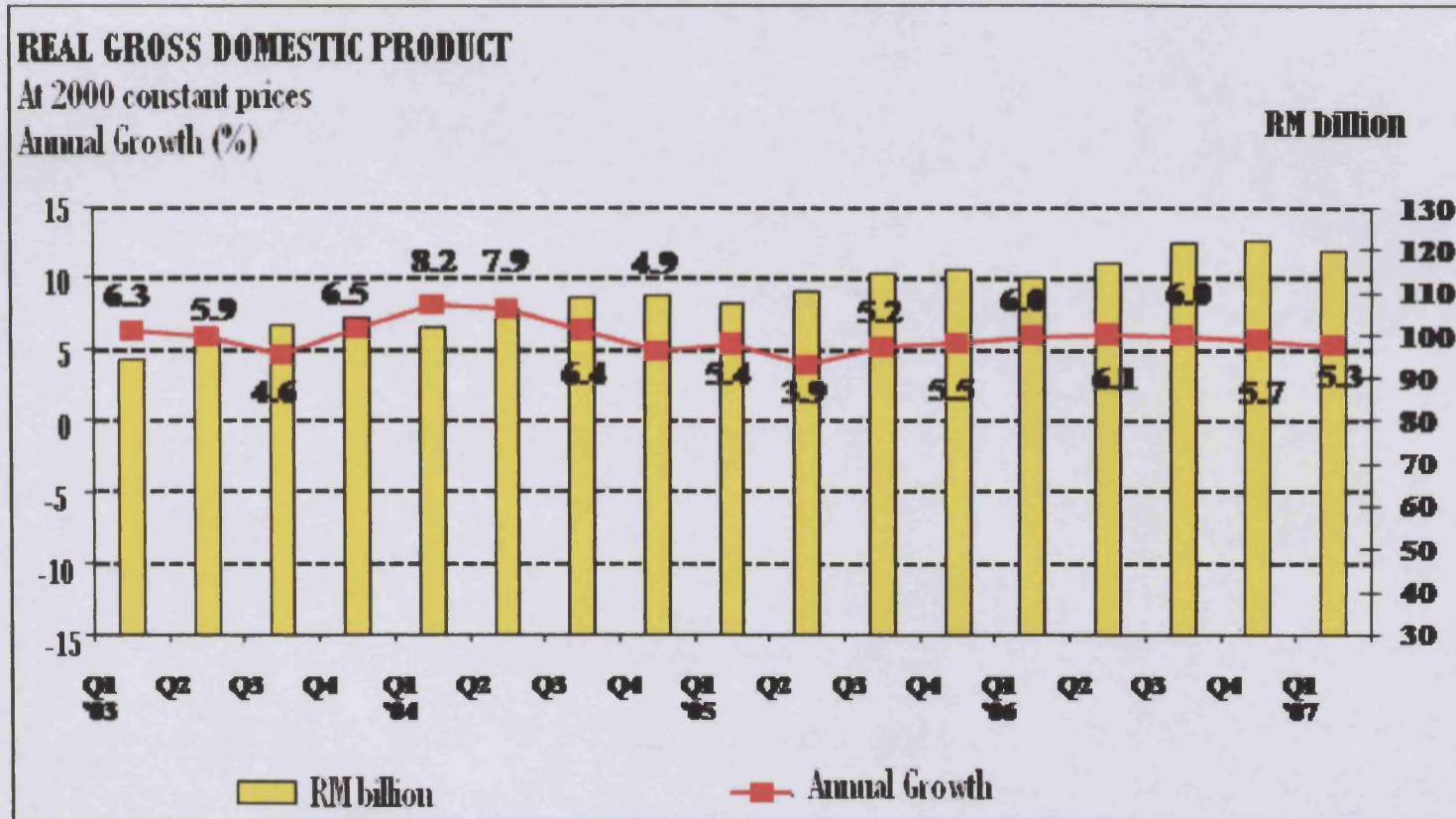
Plan Title	Duration	Date
Draft Development Plan of Malaya	1950-1955*	June 1950
Progress Report on Development Plan	1950-1952	1953
General Plan of Development	1956-1960	October 1956
Second Five Year Plan	1961-1965	1 September 1961
Interim Review of Second Year Plan	1961-1965	December 1963
First Malaysia Plan	1966-1970	25 November 1965
MTR of First Malaysia Plan	1966-1970	25 January 1969
Second Malaysia Plan	1971-1975	25 June 1971
MTR of Second Malaysia Plan	1971-1975	20 November 1973
Third Malaysia Plan	1976-1980	5 July 1976
MTR Third Malaysia Plan	1976-1980	3 September 1977
Fourth Malaysia Plan	1981-1985	16 March 1981
MTR Fourth Malaysia Plan	1981-1985	29 March 1984
Fifth Malaysia Plan	1986-1990	21 March 1986
MTR Fifth Malaysia Plan	1986-1990	23 June 1989
OPP2	1991-2000	17 June 1991
Sixth Malaysia Plan	1991-1995	7 October 1991
MTR Sixth Malaysia Plan	1991-1995	16 December 1993
Seventh Malaysia Plan	1996-2000	5 June 1996
MTR Seventh Malaysia Plan	1996-2000	22 April 1999
OPP3	2001-2010	3 April 2001
Eight Malaysia Plan	2001-2005	23 April 2001
MTR Eighth Malaysia Plan	2001-2005	30 October 2003

Note: * 6 years duration; MTR= Mid Term Review; OPP= Outline Perspective Plan

[Source: MEPU, 2006(i)]

⁶ Malaysia gained its independence on 31st of August 1957.

Graph 2.1: The Annual Growth of Malaysia's Real Gross Domestic Product



[Source: MEPU, 2007(i)]

Table 2.2: Malaysia's Key Economic Indicators (2002 – 2006)

KEY ECONOMIC INDICATORS											
	Unit	2002		2003		2004		2005		2006 ^f	
		RM million	% p.a	RM million	% p.a	RM million	% p.a	RM million	% p.a	RM million	% p.a
1.1	Gross Domestic Product (in 1987 constant prices)	220,442	4.4	232,359	5.4	248,954	7.1	262,029	5.3	277,826	6.0
	Agriculture, forestry & fishing	19,064	2.6	20,134	5.6	21,137	5.0	21,585	2.1	22,010	2.0
	Mining	15,810	4.3	16,720	5.8	17,372	3.9	17,504	0.8	18,378	5.0
	Manufacturing	66,019	4.3	71,544	8.4	78,558	9.5	82,394	4.9	88,122	7.0
	Construction	7,251	2.0	7,359	1.5	7,248	-1.5	7,133	-1.6	7,204	1.0
	Services	127,968	5.0	133,751	4.5	142,849	8.8	152,205	6.5	161,330	6.0
1.2	Gross National Product (in 1987 constant prices)	203,169	5.0	217,155	8.9	233,084	7.3	248,030	6.4	262,462	5.8
	Private consumption	101,945	4.4	106,722	6.6	120,181	10.5	131,266	9.2	140,132	6.8
	Private investment	22,161	-15.1	22,270	0.4	20,815	25.8	31,047	10.8	34,145	10.0
	Public consumption	30,926	10.4	34,476	11.5	36,558	6.0	38,727	5.9	39,979	3.2
	Public investment	41,068	11.2	42,690	3.9	38,981	-6.7	39,128	0.4	40,194	2.7
	Export of goods & services	237,904	4.5	251,463	5.7	292,476	16.3	316,959	8.4	345,075	8.9
	Import of goods & services	216,802	0.3	225,996	4.2	272,721	20.7	293,391	7.6	322,789	10.0
	Per capita GNP	13,722		14,870		16,616		18,106		19,484	
	RM	3611		3913		4373		4761		5145	
	US\$										
		% of GNP		% of GNP		% of GNP		% of GNP		% of GNP	
1.3	Balance of payments	72,117	21.4	97,701	26.3	104,474	24.7	126,454	26.7	138,401	26.7
	Goods	-31,067	-9.3	-37,553	-10.2	-33,329	-7.5	-34,157	-7.2	-33,969	-6.5
	Services & income	30,494	9.1	50,848	13.7	56,511	13.4	75,334	15.9	89,409	17.2
	Current account balances	14,191	4.2	39,059	10.5	83,081	19.8	12,820	2.7	-	-
	Overall balance	131,394	39.2	170,452	46.1	253,513	59.9	256,354	56.3	-	-
	Central bank reserves	5.4		6.6		6.0		7.6		-	
	Months of retained imports										
1.4	Federal Government Accounts	83,515	24.8	92,808	24.9	99,397	23.4	106,304	22.5	114,569	22.1
	Revenue	68,699	20.4	75,224	20.2	91,296	21.5	97,744	20.7	101,246	19.5
	Operating expenditure	35,069	10.4	38,312	10.3	27,518	6.5	27,284	5.6	32,758	6.3
	Development expenditure (net)	-20,253	-6.0	-20,928	-5.6	-19,419	-4.6	-18,724	-4.0	-19,435	-3.7
		% of GNP		% of GNP		% of GNP		% of GNP		% of GNP	
1.5	Price Indices										
	Consumer Price Index (CPI)	% p.a	6.3	2.5	1.0	1.4	1.0	1.2	1.4	3.0	3.5 - 4.0
	Producer Price Index (PPI)	% p.a	10.7	-3.3	3.1	-6.0	4.4	6.7	0.9	0.0	-
		% of labour force									
1.6	Unemployment		3.1	3.4	3.1	3.0	3.6	3.0	3.5	3.5	3.5
1.7	Exchange Rates (average per period)										
	RM / US\$		3.920	3.800	3.800	3.800	3.800	3.800	3.800	3.800	3.844 ^a
	RM / 100Yen		3.000	3.361	3.627	3.130	3.039	3.262	3.542	3.616	3.162 ^a
	RM / S\$		2.340	2.242	2.206	2.122	2.123	2.161	2.242	2.332	2.289 ^a
	RM / Pound Sterling		6.496	6.190	6.764	6.474	5.170	6.211	6.985	7.246	6.500 ^a
1.8	Money & Banking										
	Money supply M1 ¹	RM million	54,135	73,447	78,216	80,728	89,072	102,104	114,269	124,023	126,961 ^b
	Money supply M2 ²	RM million	296,472	337,138	354,702	362,512	383,542	426,061	534,163	616,178	636,191 ^b
	Money supply M3 ³	RM million	401,459	434,690	456,496	489,519	501,125	549,649	617,639	667,327	679,254 ^b
	Commercial Banks										
	Total deposits ⁴	RM million	307,440	339,708	362,991	368,792	388,405	433,008	550,930	644,891	670,276 ^b
	Total loans ⁵	RM million	30,269	296,332	314,798	325,072	338,242	355,839	448,354	526,771	555,482 ^b
	Non-performing loans	% of total loans	6.7	5.5	5.4	7.4	6.9	6.4	5.3	4.4	4.6 ^b
	Interest rates										
	3-month inter-bank	Avg. at end-period (%)	9.43	4.00	3.19	3.13	2.92	2.00	2.54	2.00	-
	3-month fixed deposit	Avg. at end-period (%)	6.03	3.33	3.40	3.21	3.20	3.00	3.00	3.02	3.04 ^b
	Savings deposit	Avg. at end-period (%)	3.07	2.70	2.72	2.20	2.12	1.00	1.50	1.41	1.43 ^b
	Base lending rate	Avg. at end-period (%)	0.04	0.79	0.70	0.39	0.39	0.00	5.95	0.20	6.34 ^b
	3-month Treasury Bills	Avg. at end-period (%)	0.00	3.53	2.00	2.79	2.73	2.79	2.40	2.60	2.96 ^b

Notes: (f) Forecast. ^a Data as at 26 April 2006. ^b Data as at end of February 2006

¹ Currency holdings and demand deposits of the private sector

² M1 plus fixed savings and other deposits of the private sector placed with the Central Bank, commercial banks, negotiable certificate deposits and Central Bank certificates

³ Currency in circulation plus all private sector deposits with the Central Bank, commercial banks, finance companies, merchant banks and discount houses excludes placements among three financial institutions

⁴ As from April 1997 includes foreign currency deposits which were previously included in the various type of deposits

⁵ Starting from 1996 based on new classification

Sources: Economic Planning Unit, Ministry of Finance, Department of Statistics, Bank Negara Malaysia (i.e. Central Bank) and the Bursa Malaysia (Malaysia Bourse) [Sources: MEPU, 2006(ii)]

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Table 2.3: Turnover of Malaysian Industries between the Periods 2001 to 2006

Turnover ^a	2001		2002		2003		2004		2005		2006 ¹	
	Volume (mill units)	Value (RM mill)	Volume (mill units)	Value (RM mill)	Volume (mill units)	Value (RM mill)	Volume (mill units)	Value (RM mill)	Volume (mill units)	Value (RM mill)	Volume (mill units)	Value (RM mill)
Consumer Products	1,820.3	7,549.6	3,788.8	13,225.1	7,022.2	17,250.7	8,088.8	19,051.5	7,987.8	15,505.6	3,404.5	7,002.4
Industrial Products	6,625.4	9,678.7	7,399.1	13,365.0	19,865.7	30,164.6	22,841.0	32,174.3	21,079.7	22,990.3	6,913.1	5,837.7
Construction	5,074.2	8,480.3	5,388.9	10,732.5	9,245.0	17,094.7	6,883.7	13,229.0	5,943.5	9,210.3	3,354.8	3,433.3
Trading/Services	12,729.0	33,207.9	15,143.4	44,920.4	27,587.3	62,860.7	26,898.9	77,688.0	26,334.8	69,330.3	9,952.9	17,800.5
Technology ^b	831.2	3,803.6	946.2	3,688.0	6,621.7	7,734.8	8,167.7	9,016.4	10,506.1	6,537.8	11,567.3	6,007.9
Finance	8,193.7	19,645.2	7,946.3	24,059.8	13,444.2	30,964.1	12,753.6	41,553.2	2,828.7	4,913.0	1,073.6	1,721.6
Hotels	472.1	384.5	1,129.9	1,001.2	1,135.5	910.6	1,736.7	2,242.0	12,241.2	41,364.7	2,918.7	9,697.9
Properties	4,350.7	2,985.1	6,851.5	6,403.3	16,341.3	15,021.1	14,033.2	20,262.9	1,430.0	1,195.1	256.1	90.4
Plantation	1,255.8	3,045.3	1,899.9	5,962.9	3,844.9	11,024.0	5,258.1	15,062.3	12,273.7	13,117.9	4,328.6	2,239.5
Mining	137.5	193.3	246.2	589.0	193.1	387.8	110.4	353.4	3,015.3	10,616.3	752.3	3,166.7
Trusts	17.8	10.3	26.5	15.7	23.6	16.1	45.9	41.5	0.2	9.8	0.1	4.8
Infrastructure Project Companies	578.0	1,752.1	389.2	1,175.0	1,516.0	3,620.7	1,199.6	3,347.0	337.2	392.0	173.4	188.5
Closed End Fund	16.9	7.8	36.6	22.9	70.0	46.3	58.9	45.0	59.0	51.6	25.3	23.4
Exchange Traded Fund ^c	-	-	-	-	-	-	-	-	45.1	47.4	6.0	6.2
Loans	2,331.8	1,093.5	1,168.9	1,054.8	1,448.7	1,471.2	1,657.8	1,553.8	1,386.6	1,006.7	1,681.3	460.5
Loans (PN4)	-	-	6.8	1.4	2.3	0.4	-	-	-	-	-	-
TSR ^d / Warrant	10,063.1	4,148.3	8,836.5	5,194.4	13,332.2	6,210.5	10,424.9	5,501.3	11,716.0	3,604.3	2,842.5	694.2
TSR ^d / Warrant (PN4)	-	-	53.6	12.2	9.5	1.0	2.8	0.5	-	-	-	-
PN4 Condition	-	-	750.7	208.9	846.6	174.8	573.0	168.3	-	-	-	-
Trading of Rights	451.7	30.6	735.5	232.7	528.2	191.4	287.8	118.1	671.1	147.1	65.6	2.7
Call Warrants Board	-	-	-	-	1,122.2	1,192.8	1,657.5	2,453.4	963.1	1,049.9	151.4	114.3
Grant Total	54,949.2	96,016.1	62,744.5	131,865.2	124,200.2	206,338.3	122,680.3	243,861.9	118,819.1	201,090.1	49,467.5	58,492.5

Notes: Figures are inclusive Direct Business

¹ Data as at 31st March 2006

^a The Main Board, Second Board and MESDAQ Market (MESDAQ Market merged with Malaysia Bourse with effect 18th March 2002)

^b Launched on 15th May 2005

^c Launched on 18th July 2005

^d Transferable Subscription Rights

[Source: MEPU, 2006(iv)]

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Moreover, the growth of Malaysia's economy has primarily been driven by investment activities, which accounted for 40.5% of the country's Gross National Product (GNP) in 1994 (Mohamad, 1995). In terms of the country's gross domestic level, it has been growing at the average rate of 6% since the first quarter of 2003 (see Graph 2.1).

As shown in Table 2.2, manufacturing and services are the two industries that have contributed most to Malaysian GDP over the previous five years (see further Table 2.3). In addition, the growth of the export of goods and services has remained stable at 8% for the last two years. In 2006, the per capita GNP level was at its highest value and had been increasing during the past five years. Also, the Malaysian unemployment level, on average, has remained low, at 3.4%.

In addition, the country is rich in natural resources (such as petroleum), and in raw materials, has a high supply of low-cost high-skilled workers, is a member of designated economic zones to enhance business trading and scope, and has lenient tax structures and business-friendly regulatory policies (Abdul Razak, 2007). These characteristics are essential to promote a higher level of investment activities along with a broader scope of business opportunities in Malaysia.

2.1.1 *1997-1999 Economic Crisis and Recovery Plans*

From mid 1997 until the last quarter of 1999, Malaysia's economy was affected by a financial crisis (Malaysia Economic Planning Unit, 2001)⁷. In response to the crisis, the government in collaboration with the private sector and other institutions undertook several initiatives to reform and restructure the economy and introduced new rulings and policies to expedite the country's recovery. One of the recovery schemes was the imposition of currency control on 2 September

⁷ In this review, Malaysia's economy was reported to be recovering from the crisis, with a Gross Domestic Product (GDP) growth of 5.8% in 1999 and 8.5% in 2000.

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1998 by fixing the exchange rate at USD1= Malaysian Ringgits 3.8 (Low, 2000). At that time, such a decision was necessary to alleviate fluctuations in the currency rate amidst speculative activities as well as to stabilise the domestic environment. Later, beginning in July 2005, the exchange rate of the Malaysian Ringgit was administered under a managed float scheme where economic fundamentals were used to determine the currency value (Central Bank, 2005).

During the crisis period, corporate and financial reform rescue plans were set up to assist the restructuring of affected and ailing financial and non-financial companies. In particular, Danaharta, a National Asset Management Company, was formed to address the issue of raising non-performing loans (NPLs) by keeping respective loans at a manageable level. This was accomplished by removing NPLs from the balance sheets of financial institutions at a fair market value and maximising their recovery value (Zainal Abidin, 1999). Danaharta remained to administer financial institutions' recuperation period until 2005. In addition, Danamodal, a recapitalisation agency, was set up to recapitalise troubled financial institutions. For this purpose, the sum of RM 6.4 billion was injected into 10 financial institutions to protect the financial sector from potential systemic risks (Zainal Abidin, 1999). In addition, the merger of 58 financial institutions into 6 groups was initiated on 29 July 1998 as an important component of the financial sector's restructuring plan. The six groups comprised merchant banking and securities and commercial banking and finance company activities amongst others (Zainal Abidin, 1999). This measure was also undertaken to prepare domestic banks for the eventual opening of financial services under the World Trade Organisation (WTO).

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In addition, the Corporate Debt Restructuring Committee (CDRC) was commissioned to manage the out-of-court settlement of corporate debts of the corporate sector. Mainly, this involved the restructuring of companies without government support and reaching a consensus with creditors for settlement of companies' debts without full repayment. Later, in August 2002, the CDRC ceased operations after having succeeded in reducing the corporate debts of 32 companies from RM52 million to RM36 million.

Since the economic crisis, the Malaysian corporate governance outlook has been far reaching and progressive. New corporate governance rules, regulations and policies were viewed as necessary, reflecting credible long-term commitment from market players, mainly, industries and, more specifically, the accompanying companies. Significantly, such hastened the establishment of the Malaysian Code of Corporate Governance in January 2001 as part of the Kuala Lumpur Stock Exchange Revamped Listing Requirements. The long-term plan for the development of an orderly, effective and efficient competitive capital market under the Capital Market Master Plan also commenced and the Securities Commission Law and its authority were strengthened.

2.2 Malaysia's Capital Market Environment

2.2.1 *An Overview*

According to Singh and Weisse (1998), the strength of the stock market of developing countries has influenced on the development and viability of their financial structures and promoted the receipt of injections of capital from advanced economies. In particular, the level of the capitalisation ratio of the securities market is an important indicator of a country's development. In providing a conducive environment for investment initiatives, Malaysia's capital market plays

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a primary function as a platform for raising and investing capital (Mohamad, 1990; Malaysian Securities Commission, 2001). This further emphasises the importance of its efficiency to stimulate and sustain Malaysia's economic development and stability (Abdullah, 2003).

Notably, the capital market of Malaysia comprises public and private debt securities issues and equity issues (Anwar, 2005). The growth and performance of its equity market is greatly influenced by the viability of the long-term income trends of its economy (Malaysian Securities Commission, 2001). Moreover, equity market contributions and participation in private sector growth are important, notably in funding and achieving the country's aims for a knowledge-based economy and the expansion and development of its Islamic capital market and small-medium enterprise businesses (Anwar, 2005).

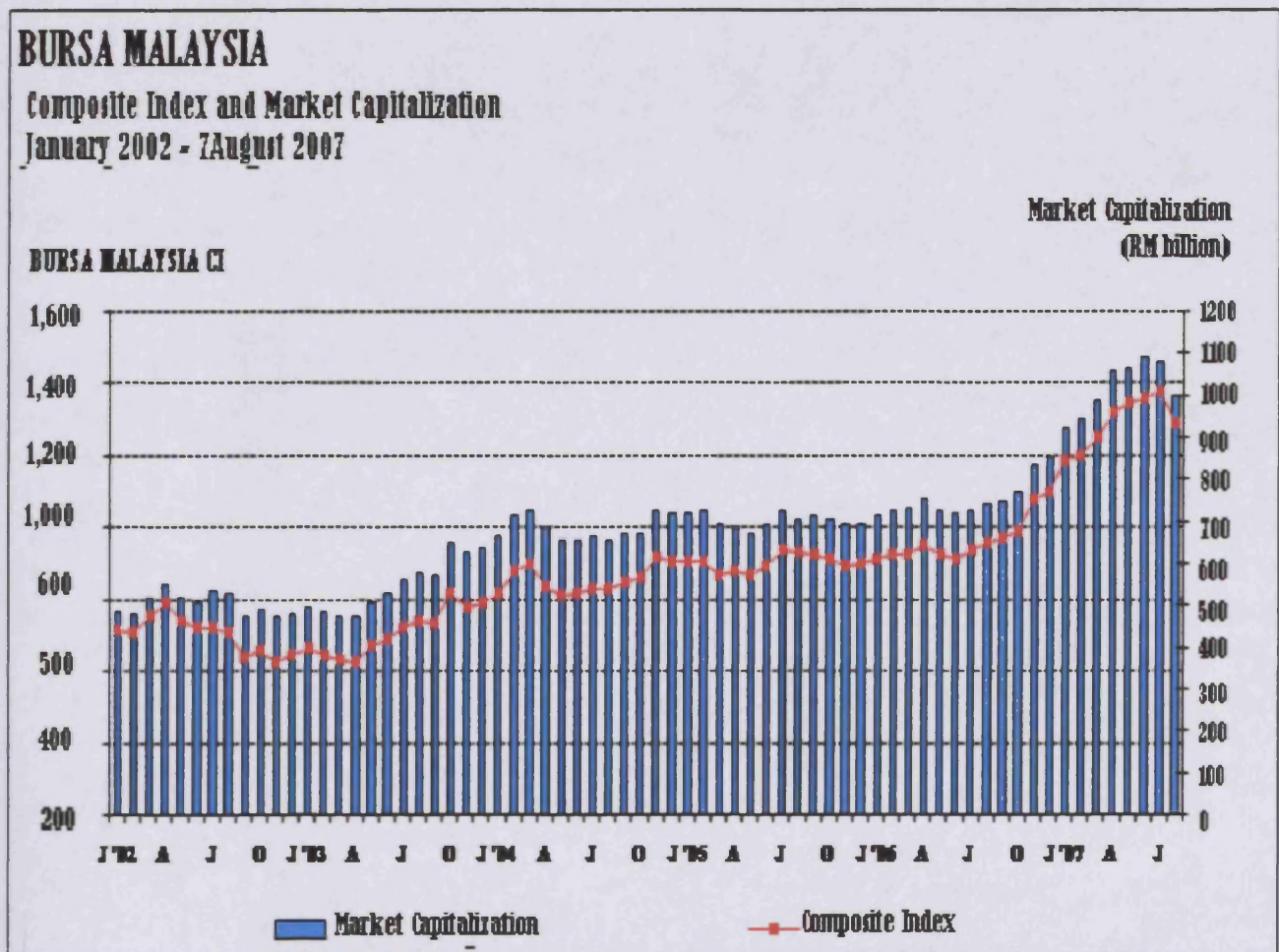
The proper functioning of a country's equity market is also affected by the governance imposed on capital market activities and the extent of legal, regulatory and institutional reliability and enforcement [La Porta et al., (1997, 1998)]. According to Li (2002), Malaysian stock market leads the highly valued equity market in developing countries with a projected worth of 95% of the capacity of its valuation frontier⁸. In addition, the Malaysian Securities Commission has implemented various schemes to strengthen the reliability of its capital market and ensure the protection of investors' investments. These include instituting and enforcing an effective corporate governance framework in listed issuers, enhancing firms' disclosures and the transparency of information and activities, and monitoring, enforcing and ensuring that directors of corporations are extensively educated, and are trained to be competent in and are committed to performing their statutory duties (Anwar, 2005).

⁸ The maximum feasible output from given inputs

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The performance of Malaysia's equity market is measured first by the Malaysia Bourse Composite Index (KLCI). This benchmark measures the performance of the 100 most successful listed corporations, and further indicates their representation in the major sectors of the Malaysian economy. It is calculated as the ratio of the current aggregate of equities market capitalisation to the base aggregate market capitalisation [see Bursa Malaysia, 2007(i)]. Further, since the first quarter of 2002, the market capitalisation of Malaysia Bourse composite index has been growing steadily (see Graph 2.2).

Graph 2.2: The Market Capitalisation of the Malaysia Bourse Composite Index (2002-2007)



[Source: MEPU, 2007(ii)]

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In the Malaysia Bourse key indicators report (see Anwar, 2005), the Composite Index showed a stimulus level of 1196.45 points, which represented its third highest achievement since its inception in 1990 and a nearly 200% improvement since its lowest point of 400 points in mid 1998, during the financial crisis period (see Anwar, 2005). Further, the issues of new equities grew steadily from 1990 to 1997. During the crisis period, participation was reduced, however, since the year 2000, activity has recovered to the momentum of the pre-crisis period (see Anwar, 2005). Between 1990 and 2007, the market capitalisation value of Malaysian equities has continued to improve [See Anwar, 2005; MEPU, 2006(iv), 2007] and presently the figure has reached Malaysian Ringgits 943.37 billions (that is, USD 268 billions⁹) [MBSB, 2007]. This amount represents the total market capitalisation of the Main Board, Second Board, Call Warrant and MESDAQ market of the Malaysian Securities Exchange.

With respect to the distribution of ownership of share capital in Malaysian corporations, the foreign investors' shareholdings in Malaysian corporations have gradually increased since 1990 (see Table 2.4). They bring in a source of funds to the country, which further contributes to the stabilisation and growth of the Malaysian economy. This fact also emphasises the importance of established laws and regulations that protect investors' interests appropriately and can be depended upon to monitor and discipline corporations' behaviour.

⁹ Based on the Central Bank of Malaysia (www.bnm.gov.my) currency exchange rate of RM 3.5115 for USD 1 on 9 March 2007.

Table 2.4: Ownership of Share Capital (At Par Value) of Limited Companies ¹

Ownership Group	1990		1995		1999		2000		2002		2004		Average Annual Growth Rate (%) 1996-2004
	RM Million	% Total	RM Million	% Total	RM Million	% Total	RM Million	% Total	RM Million	% Total	RM Million	% Total	
Bumiputera	20,877.5	19.3	36981.2	20.6	59,394.4	19.1	62,976	18.9	73,161.8	18.7	100,037.2	18.0	10.5
Individuals & Institutions	15,322.0	14.2	33,353.2	18.0	54,046.0	17.4	57,173.6	17.2	66,746.0	17.1	91,340.6	17.2	10.6
Trust Agencies ²	5,555.5	5.1	3,628	2.0	5,348.4	1.7	5,802.4	1.7	6,415.8	1.6	8,696.6	1.7	9.1
Non-Bumiputera	50,754.0	46.8	78,026.9	43.4	125,013.3	40.3	137,412.8	41.3	168,962.7	43.2	214,972.6	40.6	10.7
Chinese	49,296.5	45.5	73,552.7	40.9	117,372.4	37.9	129,318.3	38.9	159,806.9	40.9	206,682.9	30.0	10.9
Indians	1,068.0	1.0	2,723.1	1.5	4,752.9	1.5	5,136.8	1.5	5,951.1	1.5	6,392.6	1.2	8.9
Others	389.5	0.3	1,751.1	1.0	2,888.0	0.9	2,957.7	0.9	3,204.7	0.8	1,897.3	0.4	0.8
Foreigners	27,525.5	25.4	49,792.7	27.7	101,279.2	32.7	103,909.4	31.3	112,727.6	28.0	172,279.6	32.5	13.2
Nominee Companies	9,229.4	8.5	14,991.4	8.3	24,389.5	7.9	28,119.4	8.5	35,969.5	9.2	42,479.1	8.0	11.0
Total	198,377.4	100.0	179,792.2	100.0	310,076.4	100.0	332,417.6	100.0	390,821.6	100.0	529,768.7	100.0	11.4

Notes: ¹ Excludes Government Holdings (except through trust agencies)

² Refers to shares held through trust agencies, such as Permodalan Nasional Berhad (PNB) and State Economic Development Corporation (SEDCs)

Source: Economic Planning Unit and Companies Commission of Malaysia

[Source: MEPU, 2006(iii)]

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To further encourage and increase the participation of investors in the capital market, the Malaysian government has introduced several initiatives, including reducing the stamp duty for all securities trading on the Kuala Lumpur Stock Exchange (presently known as the *Bursa Malaysia*) to Malaysian Ringgits 200 (that is, USD 57¹⁰) per contract.

To facilitate further comprehension of the circumstances prevailing in Malaysia's financial and capital market regulatory environment, the following subsections will examine the roles and functions of capital market regulatory bodies in their attempts to achieve high corporate governance standards in practice.

2.2.2 *Regulatory Bodies*

2.2.2.1 **The Treasury and Ministry of Finance**

The Federal Treasury was formed in 1957, under the administration of the Ministry of Finance, mainly for the purposes of formulating, planning and implementing fiscal policies in line with the nation's medium and long-term development plans, the New Economic Policy (NEP) and the National Development Policy (NDP)¹¹. Specifically, the Finance Division of the Federal Treasury is responsible for the development of the capital and financial markets. In addition, the Central Bank of Malaysia and the Securities Commission maintain a close relationship with the Finance Division in regulating the financial¹² and capital markets in the country.

¹⁰ Based on the Central Bank of Malaysia (www.bnm.gov.my) currency exchange rate of RM 3.5115 for USD 1 on 9 March 2007.

¹¹ The objectives of these economic plans were to promote sustainable economic growth, improve national economic resilience, and ensure equitable sharing of national wealth.

¹² The money and foreign exchange markets (i.e. the capital market), the commodity futures market and the financial futures and options markets collectively form the financial markets of Malaysia.

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As regards to the monitoring of the capital market, the Finance Division responsibilities include:

- i. Ensuring that the securities laws are being complied with so that reasonable measures are undertaken to maintain investors' confidence in the securities and futures markets;
- ii. Considering and recommending reforms to the laws relating to securities and futures contracts; and
- iii. Eliminating illegal, unethical and improper practices in securities and futures markets.

(Low, 2000:27)

Moreover, the Ministry of Finance has been one of the major contributors to and active participants in the Finance Committee on Corporate Governance that was formed in 1998 to identify and mitigate the weaknesses highlighted by the economic crisis in the governance framework of industries. Subsequently, in March 1999, after extensive collaboration between various private and public parties, the Finance Committee published the Report on Corporate Governance that ultimately constituted the Malaysian Corporate Governance Code of 2001.

2.2.2.2 **Bank Negara Malaysia (or the Central Bank of Malaysia)**

The Central Bank of Malaysia was formed in 1959, following an economic proposal put forward by the World Bank in 1954 (Watson-Caine Report 1956), which subsequently led to the enforcement of the Central Bank of Malaya Ordinance in 1958 (Low, 2002:31). Primarily, its responsibilities range from monitoring monetary stability to regulating the banking industry in Malaysia.

In terms of corporate governance initiatives, the issuance of Guideline No.1 in 1994 made it compulsory for all licensed banks and insurers to form an audit committee comprising a majority membership of independent directors. Later, in the same year, this rule was incorporated by the Kuala Lumpur Stock Exchange into its Listing Requirements, further

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emphasising the importance of monitoring committee establishment and its role in promoting appropriate governance practices in listed companies.

Moreover, it recently announced further liberalisation of the administration of foreign exchange dealings and the ruling took effect from 1 April 2007. The implementation is part of the Bank's continuous efforts to enhance Malaysia's competitiveness as an international investment platform and amongst others will assist in:

- (i) Providing greater flexibility to licensed onshore banks to undertake foreign currency business,
- (ii) Facilitating non-residents investments in Ringgit assets and financial products and
- (iii) Reducing the cost of doing business and ensure greater business efficiency.

[Source: Central Bank of Malaysia (BNM), 2007]

2.2.2.3 Securities Commission of Malaysia (SC)

The Securities Commission was established in March 1993 under the Securities Commission Act 1993 (SCA) as a self-funding statutory body. Officially, the Commission is responsible for:

- supervising exchanges, clearing houses and central depositories
- registering authority for prospectuses of corporations other than approving
- authority for corporate bond issues
- regulating all matters relating to securities and futures contracts
- regulating the take-over and merger of companies
- regulating all matters relating to unit trust schemes
- licensing and supervising all licensed persons
- encouraging self-regulation
- ensuring proper conduct of market institutions and licensed persons

(Source: Malaysia Securities Commission, 2003)

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From the capital market perspective, the Commission plays a major role in developing, regulating and sustaining the securities and futures markets in Malaysia, given that it is answerable to the Ministry of Finance and that its rules and regulations are gazetted in the Parliament. Its powers range from investigating breaches of securities regulations to enforcing rules and regulations and prosecuting securities offences. In preparing and establishing the strategic future direction of the Malaysian capital market, the Commission deployed a 10-year plan in 2001 under the Capital Market Master Plan (CMMP). Primarily, the CMMP was executed as a response to the debilitated state of the capital market during the economic crisis, and to facilitate future business development and the creation of a competitive capital market in Malaysia.

Predominantly, the Commission aimed to shift the regulatory framework from a merit-based regulatory scheme¹³ to a disclosure-based regulatory system, recognising the latter's usefulness and appropriateness in an era of business globalisation, technological and financial innovation, and the rapid production and flow of information (Malaysia Securities Commission, 1998). In particular, a disclosure-based regulatory system could be expected to permit the liberal involvement and participation of private sector companies in managing their own investment decisions and hence would promote efficient and equitable capital allocation and decision-making in Malaysia's capital market (Malaysia's Security Commission, 1998).

As such, this move helped to improve the standard and operation of capital market activities and facilitate reinforcement of the capital market regulatory framework. Notably, the disclosure-

¹³ Under this scheme the State had assumed a paternal role in assessing the importance of investment opportunities by playing the role of intermediary between users and suppliers of capital.

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based regulatory system would be further enhanced by the adoption and implementation of the new system of co-regulation or sharing of regulatory powers amongst industries, regulators and other market observers. In addition, this would also provide a solid base for company participation in the practices and enforcement of good corporate governance in their operations.

2.2.2.4 **Bursa Malaysia Securities Berhad [or Malaysia Bourse Securities Limited (MBSB)]**

The Kuala Lumpur Stock Exchange (KLSE) was established in 1973, following agreement by the Malaysian and Singaporean governments to administer a separate securities exchange¹⁴. However, it was officially de-linked from the Singapore Stock Exchange in 1990. Two decades later, in April 2004, the KLSE was de-mutualised and re-named Malaysia Bourse Securities Limited (hereinafter refers as MBSB)¹⁵. The restructuring was vital in providing and developing strong and competitive financial intermediaries (Anwar, 2005).

Primarily, the MBSB functions as a self-regulatory organisation for the capital market. Among others, its responsibilities include governing the conduct of its members in securities dealings, surveillance of the marketplace, and the enforcement of listing requirements (MBSB, 1998). Moreover, its close collaboration with the Central Bank (Bank Negara), the Securities Commission, and the Ministry of Finance, has helped strengthen its position as a safe, secure and attractive investment platform, which is important in establishing an internationally competitive market place for fund raising and investment (MBSB, 2006).

¹⁴ At that time, it was called the joint Stock Exchange of Malaysia and Singapore.

¹⁵ See 'KLSE Converts to Public Company Limited by Shares' [See MBSB, 2004(i)]

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The MBSB's efforts to improve and implant good governance practice in listed companies were assisted in 1987 with the addition of a new section on corporate disclosure policies and penalties in the new listings manual. Shortly after, in 1993, the MBSB ruled all listed companies must form an audit committee. Eight years later, in January 2001, Revamped Listing Requirements were endorsed, making it compulsory, starting from June 2001, for all listed companies in Main Board, Second Board and MESDAQ Board to produce a corporate governance statement and related information in their annual reports as prescribed by Chapter 15 of the Malaysia Bourse Listing Requirements 2001.

Most important of all, the corporate governance disclosure requirements of the Revamped Listing Rulings adopted the Malaysian Code of Corporate Governance 2001 Principles and Best Practice. Additionally, to safeguard investors' interests and the market trading share, in February 2001, with the issuance of Practice Note No.4 (PN4), the Malaysia Bourse temporarily de-listed companies that did not meet the minimum financial requirement and classified them as PN4 companies (MBSB, 2002). These companies were given a specific time to undertake corporate and financial restructuring. Encouragingly, since then, the number of PN4 companies has reduced from 100 to 20 companies (see further MBSB 2002, 2006(a) and Table 2.3).

There are four main indices in MBSB (see Table 2.5), namely, the Composite Index (which represent the index of the top 100 main board companies), the Emas Index, the Second Board Index [which represents listed companies with paid up capital between MR 40 million (USD 11.21 million) and MR 60 million (USD16.82 million)], and the MESDAQ index.

Table 2.5: The Performance of the Malaysia Bourse Securities Limited Indices in Year 2001 to 2006

BURSA MALAYSIA	2001	2002	2003	2004	2005	2006
<u>Bursa Malaysia Index</u>						
Composite Index	696.1	646.3	793.9	907.4	899.8	926.6
Emas Index	165.2	157.3	195.6	214.3	203.9	213.4
Second Board Index	134.1	98.2	140.6	110.9	80.4	91.1
MESDAQ Index	88.1	83.3	152.3	162.5	87.1	111.2
Market Valuation (RM billion)	465.0	481.6	640.3	722.0	695.3	732.9
<u>Selected World Stock Market Indices</u>						
Dow Jones New York	10,021.5	8,341.6	10,453.9	10,783.0	10,717.5	11,109.3
Nikkei, Tokyo	10,542.6	8,579.0	10,676.6	11,488.8	16,111.4	17,059.7
Hang Seng, Hong Kong	11,397.2	9,321.3	12,575.9	14,230.1	14,876.4	15,805.0
<u>New Listing</u>						
Main Board	6.0	22.0	16.0	15.0	13.0	-
Second Board	14.0	22.0	22.0	26.0	17.0	-
MESDAQ Market	-	7.0	20.0	31.0	46.0	7.0
Total	20.0	51.0	58.0	72.0	76.0	8.0
<u>Listed Company</u>						
Main Board	520.0	562.0	598.0	622.0	646.0	645.0
Second Board	292.0	294.0	276.0	278.0	268.0	266.0
MESDAQ Market	-	12.0	32.0	63.0	107.0	114.0
Total	812.0	868.0	906.0	963.0	1,021.0	1,025.0

[Source: MEPU, (2006(iv))]

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Recently, MBSB has announced its plans to increase efficiency in the market's infrastructure and improve investors' means of investing, aimed mainly at increasing the degree of transparency in the market [*The Star*, 2007 (iv)]. This includes completing the infrastructural and regulatory framework for allowing foreign entities to be listed on the Stock Exchange. By June 2007, the Bursa had launched a trading fund based on its FTSE-Bursa Malaysia 30, to give investors immediate exposure to 30 of Malaysia's largest listed corporations. A tradable Syariah Index was introduced simultaneously to promote and expand Syariah-based investment opportunities to investors.

Previously, the MBSB had focused on improving market liquidity and velocity by investing in high-technology equipment to establish an integrated trading platform, the Bursa Trade, for the derivatives market and to improve the infrastructures for equities trading [*The Star*, 2007 (iv)], whilst, for the bonds market, the Stock Exchange had undertaken to establish an electronic trading platform equipped with order matching, trade negotiation, trade reporting, surveillance and price dissemination.

2.2.2.4.1 MBSB Public Listed Companies' Listing Requirements

The Malaysia Bourse Securities Limited listing requirements 2001 significantly incorporated the recommendations of the Malaysian Code of Corporate Governance 2001 recommendation into Corporate Governance Principles and Best Practices. Moreover, the revamped listing rulings, combined, supplemented and incorporated previous Main Board Listing Requirements (MBLR) and Second Board Listing Requirement (SBLR) to form standardised rules for both boards (MBSB, 2001 (a): Question 3). In addition, to assist listed issuers' further understanding and

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adoption of the new requirements, the Exchange, through its Practice Notes, detailed the required implementations of and related changes in the newly enacted listing provisions.

Moreover, the listing rulings of the Main Board and Second Board are motivated by the Exchange objectives to:

- (i) Improve listed issuers' governing practices and transparency
- (ii) Increase efficiency in capital market activities
- (iii) Enhance investors' protection
- (iv) Restore and encourage investors' participation in capital market activities

[Source: MBSB, 2001(a): Question 1]

Further, extensive measures have been put in to ensure the realisation of good corporate governance objectives, ease of adoption by listed issuers, and safeguarding of investors' vested interests by:

- (i) Strengthening the provisions of disclosure, corporate governance, continuing listing obligations, financial reporting and protection of minority interests
- (ii) Codifying unwritten rules and procedures relating to listed issuers
- (iii) Simplifying procedural requirements and processes
- (iv) Clarifying requirements and removing ambiguities, and
- (v) Adopting global trends and standards in listing rules where applicable

[Source: MBSB, 2001(a): Question 1]

Notably, the listing requirements of paragraphs 9.03 of the Exchange Rulings (see Appendix 2A) relating to the scope and quality of material information signify the Exchange's constant awareness of investors' need for reliable and credible information to make informed economic judgements on their investments. In addition, paragraph 9.19 of the Exchange rulings identifies those events that require immediate announcements to the Exchange by listed corporations.

These include a change in the composition of the board of directors and audit committee of the listed issuer, in the chief executive officer, company secretary, or external auditor of the listed issuer, the memorandum of association or articles of association, the acquisition and disposal of shares and a deviation of 10% or more between the profit after tax and the minority interest estimated profit.

2.3 An Overview of Corporate Governance Issues in Malaysia

According to Johnson and Mitton (2001), the bias the Malaysian government shows to entrepreneurs' well-being may not effectively assist investors' protection. As Johnson and Shleifer (2001) point out, a country with a weak legal system requires strong support from its regulator to ensure investors' protection and to strengthen the credibility of its financial market. Moreover, the East Asian 1997 financial crisis demonstrated the importance of establishing formal rules and regulations to monitor and discipline corporations' behaviours and to secure investors' investments (World Bank, 1998).

Moreover, many family businesses in South East Asia practise self-monitoring to ensure appropriate and sufficient governance of their firms (Khan, 1999). Notably, senior leaders will participate in the training of new management teams to ensure the efficient and effective running of the business. Claessens et al., (1999) also noted that in South East Asia the inherent concentrated ownership in large corporations by individuals, family members and the state requires an appropriate monitoring mechanism at board level to protect investors' interests from being expropriated by substantial shareholders who are also board members. Further, Thillainathan (1999) identified a serious effect of the pyramidal and cross-holdings structure of

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many corporations in Malaysia. Notably, these structures of ownership allow insiders that have majority control to pursue private rent seeking disguised as transfers of assets from a holdings company to subsidiaries or vice versa.

According to Dogan and Smyth (2002), main political parties in Malaysia are substantial shareholders of various listed companies. The business relationship between Malaysian corporations with politically influential individuals and the government has also been documented by Gomez and Sundaram (1997). The significance of this association is that it allows the company to gain access to government projects, which are high in value. In return, some corporate leaders support the election expenses of politically influential politicians (see Gomez and Sundaram, 1997). In another study, Aziz (1999:22) highlighted the mismanagement of government projects by United Engineers Berhad, a company that was too inexperienced to conduct large and complex civil engineering works, but was granted the contract to build public motorways. It was found that the owner of the company had close links with the Finance minister at that time.

In East Asian economies, founder-owned firm and public listed firms are seen as contributors to economic growth, employment and stability (Scott, 1999). In the case of Malaysia, the pervasive insider corporate governance system, the higher level of concentrated ownership, the cross-holdings and the significant participation of owners in management emphasise the important role of independent directors in overseeing and controlling management misappropriation (Khatri et al., 2002)

2.4 Corporate Governance Initiatives in Malaysia

In the following sections the corporate governance initiatives undertaken by Malaysia regulatory bodies and private organisations are further discussed

2.4.1 *The High Level Finance Committee and Working Groups and Malaysian Code on Corporate Governance*

The High Level Finance Committee and Working Group on Best Practices in Corporate Governance were formed during the financial crisis in 1998 to examine the weaknesses in the corporate governance practice in Malaysian industries with the aim of producing a set of best practices that would command effective and respectable business conduct (Finance Committee, 1999; United Nations, 2001). The committee was chaired by the Secretary General of the Treasury, Ministry of Finance and its members comprised of the Governor of the Central Bank, the Chairman of the SC, the Chairman of the Kuala Lumpur Stock Exchange (presently known as the Malaysia Bourse Securities Limited), the Chairman of the Financial Reporting Foundation and representatives of various industry organisations.

Meanwhile, two working groups were established by the high level Finance Committee to develop its proposed corporate governance and best practices framework. The first group was the working group on best practices in corporate governance (JPK1), responsible in developing best practices standards for the industry and training programmes for corporate individuals (MCCG, 2001). Whilst, the working group on law reform issues in corporate governance (JPK2) was formed to improve certain key elements of corporate regulations to establish an effective enforcement mechanism on the implementation of good corporate governance practice by companies. This was imperative to promote investor confidence in the capital market (FCCG,

1999). Subsequently, in 1999, the Malaysian Code of Corporate Governance was endorsed by the working group on best practices in corporate governance (JPK1).

2.4.1.1 **Malaysian Institute of Corporate Governance (MICG) and the Malaysian Code of Corporate Governance (MCCG)**

In March 1998, the High Level Finance Committee on Corporate Governance formed the Malaysian Institute of Corporate Governance (MICG)¹⁶ under the Companies Act 1965, which is mainly responsible for raising the awareness and implementation of good corporate governance in Malaysian industries. Namely, it concentrates on issues of management and the conduct of corporations in Malaysia, with the objectives of inspiring and safeguarding shareholders' initiatives for long-term value creation and enhancing the financial prosperity of businesses (MICG, 2001). On the public side, it aims to build up and encourage shareholders' awareness and involvement in corporate governance issues. Membership of the MICG comprises of the Federation of Public Listed Companies (FPLC), Malaysian Institute of Accountants (MIA), Malaysian Association of Certified Public Accountants (MICPA), Malaysian Institute of Chartered Secretaries and Administrators (MAICSA), and Malaysian Institute of Directors (MID). The MICG functions include:

- (i) Providing continuing education programmes on corporate governance development and best practices to company directors, chief executive officers, company secretaries, company advisers, company auditors, accountants, lawyers, members of audit committees and investors in Malaysia.
- (ii) Providing advice, technical and support services on the establishment of corporate governance best practices in organisations.

¹⁶A non-profit public company limited by guarantee

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- (iii) To work closely with stakeholders, regulators, investors, business and professional bodies, educational institutions and relevant authorities in strengthening the integrity and governance of the corporate sector. *(Source: MICG, 2004)*

Officially, the Malaysian Code of Corporate Governance was published by the MICG in January 2001. The Code is divided into three main parts: the Principles of Corporate Governance, Best Practices in Corporate Governance, and Principles and Best Practices for Corporate Governance Participants.

The Principles of Corporate Governance emphasise the significance of the following elements:

i. Board of Directors

Corporate governance principles requires the firm to be managed by an effective board, the board's power to be balanced by appropriate representation of executive, non executive and independent directors on the board, board members to be supplied with timely and quality information for the better accomplishment of duties, the firm to establish and implement transparent procedures for board appointments, and the company to carry out a re-election process of board members every three years.

ii. Directors' Remuneration

Regarding this aspect, the Code emphasises the importance of setting up an appropriate compensation package for retaining competent directors to ensure a firm's long-term success. In the case of executive directors, their pay structure should be commensurate with the corporation's and their individual performance. In respect of non-executive directors, their experience and level of responsibilities represent the main elements for setting their level of remuneration. Further, the company needs to establish formal and fair

remuneration policies and procedures for directors' compensation. Moreover, the transparency of directors' remuneration can be enhanced by the disclosure of each director's pay in the annual report.

iii. Shareholders' Communication

In this case, the Code focuses on the significance of communication between a firm and its investors, primarily, the institutional shareholders. It encourages both parties to take the initiative to establish consistent dialogue between them based on mutual understanding of objectives. In addition, companies should also use annual general meetings to establish direct contact with private investors and promote their participation in the firm's well-being.

iv. Accountability and Audit

The three main areas of concern of the Code here are the roles of the board and its duties in overseeing the firm's financial reporting, its internal control practices, and its relationship with auditors.

To strengthen the effectiveness of the board of directors' fulfilment of its duties and hence firm performance, Best Corporate Governance Practices to promote board responsibilities include:

- being vigilant when monitoring the firm's internal control system with respect to its reliability and adequacy to detect in time the firm's risks regarding the subsequent implementation of corrective measures, and overseeing company compliance with respective laws, regulations, rules, directives and guidelines
- accountability and audit, exclusively the Audit Committee's anticipated role and functions.

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- ensuring business decisions are made with shareholders being aware and sufficiently informed of the company's operations in concurrence with its policies, and being offered facilities to give feedback on respective matters
- ongoing dialogue between companies and investors, persuading institutional investors to participate in the direct investigation of the company's performance, and shareholders' concerns being communicated directly to the top management, the Board and senior management
- evaluation of Governance Disclosures, highlighting the importance of institutional investors and firm's advisers assessing critically the board's composition and structure and board members' investment in other firms
- ensuring external auditors' relationship with the shareholders demonstrates their independent statutory and professional conduct, and financial reporting practices and internal control measures reflect the prevailing position.

2.4.2 *Minority Shareholders' Watchdog Group (MSWG)*

Incorporated in 2000, as a public company limited by guarantee, as a result of a proposal made by the Finance Committee on Corporate Governance in 1999, the organisation aims to improve corporate governance practices in Malaysian industries. Since the commencement of its operation in 2002, it has the potential to promote better and more effective corporate governance practice given the presence of the Code on Corporate Governance (MWCG, 2001). Moreover, in 2002, it was granted an Investment Adviser Licence, expanding and strengthening further its role, and improving its capability to protect and represent minority shareholders' interests.

2.4.3 *MBSB and Best Practices of the Corporate Governance Disclosure Task Force*

The main duties of the Corporate Governance Disclosure Task Force¹⁷ are to facilitate public listed companies' compliance with the Malaysia Bourse Listing Requirements in respect of the Corporate Governance Code of Best Practices in light of their voluntary implementation (Best Practices Task Force, 2004). Significantly, compliance with the Best Practices Code is emphasised as a means of safeguarding market integrity; monitoring corporate information disclosure standards, quality and credibility; and encouraging companies' commitment to building a good relationship with investors.

Further, companies are advised to establish a Company Disclosure Policies and Procedures committee, the key function of which is to oversee the administration and achievement of credibility in the dissemination of corporate information disclosures, feedback and announcements. To achieve this aim, boards of directors are given the ultimate responsibility for ensuring their appropriate and sufficient implementation. Board members are further recommended to instigate frequent communication with members of top management to assure the practicality and suitability of corporate disclosure policies and practices.

2.4.4 *PricewaterhouseCoopers (PwC) Survey of Malaysia Bourse Main Board Companies 2005*

The PwC (2005) survey of Main Board listed firms' corporate governance practices (see Table 2.8) indicated that corporations were implementing the Principles of the Malaysian Code on Corporate Governance and Best Practices appropriately.

¹⁷ The task force comprises executive members of Bursa Malaysia Securities Limited, several professional bodies, namely, the Malaysia Institute of Corporate Governance (MICG), accountants, regulatory boards (i.e. the MIA, MICPA), the association of chartered secretaries (i.e. MAICSA), asset management companies, merchant banks associations and accounting firms (i.e. BDO Governance Advisory).

Table 2.6: Main Board Companies Corporate Governance Practices

[Note: Number of Respondents – 105 Main Board Firms (that is, 30 of these firms are Bursa Malaysia Top 100 companies)]

A. BOD Composition, Structure and Size

i. Size of Board of Directors

- On average, 30 of the total 105 firms in the top 100 group (*henceforth referred to as MBTop*) employed 8 members on their BOD.

ii. Managing Director/ CEO Board Membership:

- More than 2/3 of the firms (that is, 79%) appointed their Managing Director/ CEO to the BOD.

iii. Composition of Independent (INED), Non Executive (NED) and Executive Directors (ED) in BOD

- Commonly, the firms appointed 4 INED, 3 NED and 2 ED on their BOD.

iv. Chairman of BOD

- 80% and 20% of firms appointed NED and ED as Board Chairman (where 8% of the latter Chairmen also held a position as Managing Director/CEO of the company).

B. BOD Process

i. Frequency of Board Meetings

- Notably, the MBTop firms conducted more board meetings annually than their counterparts since the former on average had held 6 meetings in comparison to 5 meetings in the case of the latter.

ii. Length of Meetings

- At the top quartile of 1%, this group of firms spent 6 hrs in board meeting(s)
- The next quartile of 28% firms spent 3-6 hours in board meeting(s)
- More than 2/3 (that is, 71%) of firms spent less than 3 hours in board meeting(s)

C. BOD Members' Performance Review

i. Formal Performance Assessment -

- Overall, 54% of the firms practised a formal appraisal of their Board of Directors' performance
- However, this practice was more common in MBTop firms (that is, 71%).

ii. The Practice of Board and Individual Appraisal -

- 64% of the firms reviewed their board members' service through the BOD evaluation, and 41% also adopted a Peer and Self-evaluation method.

iii. Other Forms of Appraisal

- The 105 firms specifically appointed the BOD Chairman and Nomination Committee to appraise other board members' achievements.

iv. Measures of Directors' Performance

- More than 35% of the firms evaluated their BOD members' performance based on the level of the firm's profit.
- A sizeable number of firms i.e. more than 30%, had been benchmarking their BOD members' performance against the firm's revenue level.
- Several firms i.e. more than 20% assessed their board members' achievement based on the firm's cost-savings rate and this group of firms represented more than 25% of MBTop firms
- More than 20% of firms also used customer satisfaction level as their BOD members' achievement standard.

More than 1/5 of firms and more than ¼ of MBTop companies rewarded their board members based on the improvement in the firm's share price.

Table 2.6: Main Board Companies Corporate Governance Practices (Continued)

{Note: Number of Respondents = 105 Main Board Firms (that is, 30 of these firms are Bursa Malaysia Top 100 companies)}

<p>D. Board Remuneration</p> <p><i>i. Method of BOD Compensation:</i></p> <ul style="list-style-type: none"> ▪ Fixed Fee and Meeting Fees were common methods of remuneration for all the firms <ul style="list-style-type: none"> ↓ In particular, MBTop firms paid higher amounts for these than other firms ↓ The level of fees were set and approved at the annual general meeting ↓ 55% of firms extended such payments to include their board members' directorship of subsidiaries. <p><i>ii. Non Executive Directors' Compensation</i></p> <ul style="list-style-type: none"> ▪ Over time, the level of Non Executive Director payments had been progressively increasing, such that Independent Non Executive Directors were benefiting more with the highest rise in their level of compensation. ▪
<p>E. Board Benefit</p> <p><i>i. Company Cars for Board Chairman</i></p> <ul style="list-style-type: none"> ▪ This was a privilege for 50% of firms' BOD chairman <p><i>ii. Stock Options Payment</i></p> <ul style="list-style-type: none"> ▪ This type of compensation was common to the Executive Directors of 40% of firms. Independent and Non Executive Directors were rarely remunerated with this type of benefit <p><i>iii. Top Management Benefits</i></p> <ul style="list-style-type: none"> ▪ 83% of firms had established this type of benefit scheme for their executive director <p><i>iv. Other General Benefits Schemes</i></p> <ul style="list-style-type: none"> ▪ Boards of Directors in 51% of firms were protected with Directors' Liability Insurance. ▪ More than 42% of firms provided an insurance coverage service for their BOD members ▪ More than 36% of firms supplied medical coverage for their BOD members
<p>F. Board Committees</p> <p><i>i. Core Board Committees' Formation</i></p> <ul style="list-style-type: none"> ▪ All firms had formed audit committees (ACs) ▪ Less than 11 companies had not yet established a nomination and remuneration committee <p><i>ii. Board Committees' Composition</i></p> <ul style="list-style-type: none"> ▪ There was at least one Independent Non Executive Director on each AC, NC and RC ▪ In all firms, 99% of their AC members were INED and 35% included a BOD Chairman in their AC. ▪ For companies with a NC, 90% of members were INED and 48% had a BOD Chairman on the committee. ▪ INED composition in firms with a RC was 88%, and 46% of these firms also selected the BOD Chairman as a committee member. <p><i>iii. Size of Board Committees</i></p> <ul style="list-style-type: none"> ▪ The majority of firms appointed at least three members for each AC, NC and RC <p><i>iv. Board Committees' Frequency of Meeting</i></p> <p>In all firms, the AC convened more meetings than the NC and RC such that:</p> <ul style="list-style-type: none"> ▪ On average, the AC held 5 meetings, with a minimum number of 3 and a maximum number of 16 meetings. ▪ On average, the NC and RC conducted 2 meetings, with a minimum number of 1 and a maximum of 7 meetings.

Table 2.6: Main Board Companies Corporate Governance Practices (Continued)

(Note: Number of Respondents = 105 Main Board Firms (that is, 30 of these firms are Bursa Malaysia Top 100 companies).)

v. Committees Members' Remuneration

- AC members were remunerated with both fixed fees and meeting fees. The AC chairman and members were paid higher than their NC and RC counterparts
- Commonly, NC and RC members were remunerated based on meeting fees. However, some companies included a committee payment scheme as a fixed fee.

vi. Other Board Committees

- 56% of firms had extended the support of their current core board committees with the formation of specific committees:
 - ↓ 36% of firms had formed an Executive Committee
 - ↓ 7% had set up a Finance Committee
 - ↓ 6% had established an Investment Committee
 - ↓ An Executive Share Option Scheme Committee, Risk Management Committee and/or Corporate Committee had also been set up by these firms.

(Source: Extracted from PwC, 2005)

Notably, the frequency of board meetings exceeded the required number of meetings for interim reviews. Also, the practice of reviewing board members' performance both by peer and self-assessment helped in monitoring the board's accomplishment of duties, and participation and contribution towards shareholders' value enhancement.

In addition, the independence and credibility of individuals nominated as board members was assured by the Top 100 companies' positive response to the suggestion of establishing a nomination committee comprising mainly independent directors to appraise, select and appoint prospective board members. Moreover, a significant majority of Top 100 companies had formed a remuneration committee with a majority of independent directors as members indicating their commitment to establishing a fair executive compensation scheme in keeping with the company's level of sustainability and long-term value attainment.

2.4.5 *The Establishment of Board's Subcommittees in Malaysian Corporations*

2.4.5.1 **Audit Committee**

The requirement for Malaysian public listed companies to establish an audit committee was made by the Kuala Lumpur Stock Exchange on 1 August 1994 (Ruin, 2003:5). It was further stipulated that the audit committee be composed of a majority of independent directors. Later, in January 2001, in light of the Asian financial crisis between 1997 to 1999 and cases of corruption and fraud by big international corporations, greater awareness of the importance of good corporate governance was indicated with the adoption of the principles and best practices of the Malaysia Code of Corporate Governance (MCCG, 2001) by the KLSE Revamped Listing Rulings 2001.

The provisions for audit committee composition were extended to include the following:

- i) At least one of its members must be a member of the Malaysian Institute of Accountants or else a person with at least three years' working experience where the person:
 - (a) *has passed the examinations specified in Part I of the 1st Schedule of the Accountants Act 1967, or*
 - (b) *is a member of one of the associations of accountants specified in Part II of the 1st Schedule of the Accountants Act 1967;*
- ii) None of its members can be an alternate director and
- iii) Its Chairman must be an independent director

(Source: Para 15.10: Part C, KLSE Revamped Listing Requirements, 2001)

Later, in 2002, Para 15.10: Part C of the Listing Requirements on the accounting and financial qualification of audit members was expanded to include any "other related respective qualification that fulfils the requirement as prescribed by the Exchange". This stipulation was

elaborated upon in KLSE Practice Note Number 13 Para 7.1 (2002), which described acceptable related knowledge as:

- (a) a degree/master's/doctorate in accounting or finance and at least three years' post qualification experience in accounting or finance, or
- (b) at least seven years' experience as the chief financial officer of a corporation or having the function of being primarily responsible for the management of the financial affairs of a corporation.

2.4.5.2 Nomination and Remuneration Committee

The formation of nomination and remuneration committees by Malaysian public listed companies is voluntary and is part of the corporate governance best practices guidelines of the Malaysian Code of Corporate Governance 2001. Even though firms are not obligated to establish such committees, in their annual reports they must explain and justify their non-compliance with best practices (KLSE Revamped Listing Requirements, 2001; MCCG, 2001: 7).

Specifically, the MCCG (2001:13) encourages listed firms to establish a nomination committee that is composed exclusively of non-executive directors with a majority of independent directors. Its functions include recommending to the board nominees for prospective board membership and the appointment of directors to the various board committees, and carrying out the continual assessment of present directors' performance. In considering candidates for board membership, the committee should take into account the recommendations of the CEO, senior executives and shareholders. In addition, the committee is also responsible for making an annual

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assessment of the board of directors' required mix of skills, experience and other qualities and, in particular, the core-competencies that non-executive directors bring to the firm.

The MCCG (2001) recommends that listed companies establish a remuneration committee consisting wholly or mainly of non-executive directors. The committee's main function is proposing to the board the remuneration payments of executive directors after appropriately evaluating management propositions and obtaining external advice regarding such remuneration wherever necessary. On the other hand, the remuneration of non-executive directors is determined by the board as a whole, with directors abstaining themselves from the discussion of their compensation (MCCG, 2001:15).

2.5 Conclusion

In this chapter, the research setting has been delineated by reviewing Malaysia's independence and post-independence economic activities and development plans tailored to change the country's economy from a heavy reliance on mineral resources (such as tin) and plantations (such as rubber), and to improve the standard of living of its citizens. Subsequently, this chapter focused on the functions of the capital market regulators and authorities in setting capital market regulations, providing safe investment platforms and protecting investors' investments. The chapter also drew attention to the country's economic crisis in 1997 that forced the Malaysian government, regulatory bodies and private institutions to establish the Malaysian Code of Corporate Governance and Best Practices to monitor and strengthen the credibility and viability of its corporations. Chapter 3 presents several corporate governance theories that have been

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proposed regarding the roles, functions and contributions of boards of directors to firm performance.

Chapter 3

Literature Review I:

~Theoretical Perspectives on Corporate Governance~

3.0 Introduction

In the preceding chapter, Malaysia's economic activities, capital market authorities and corporate governance initiatives were described to provide insight into the research environment. To further the aims of this research on corporate governance practice, this chapter presents an examination of the purposes and roles of a board of directors and its subcommittees through discussion of several corporate governance theories, extended to include the effect of directors' contributions and the fulfilment of their duties on firm performance.

3.1 Theoretical Perspectives on Corporate Governance

The key roles of the board of directors in the governance of a corporation, particularly its influence on firm performance, have been the focus of many corporate governance theories, including the legalistic perspective, resource dependency view, agency theory, managerial-class hegemony, stakeholder theory and stewardship theory (Jensen and Meckling, 1976; Fama, 1980; Freeman, 1984; Zahra and Pearce 1989; Donaldson and Davis, 1991; Clarke, 2004). Specifically, these theories discuss the main roles of firms' board of directors, their distinctive attributes and, consequently, their influence on firm performance. These are crucial in evaluating and determining a board's contribution to firm value (Zahra and Pearce, 1989). While most of the philosophies concur on the importance of outside directors' role to facilitate independence in a firm's governance, stewardship theory emphasises executives' distinct functions in a firm's management (Donaldson and Davis, 1991). Uniquely, this theory perceives

the inclusion of the CEO and other executives on the board of directors as strategic; executives' direct involvement in a firm's day-to-day operations implies their greater knowledge of the firm's activities in comparison to that of outside directors. Regarding a corporation's top authority, it supports the duality of appointment of the CEO as the board Chairman. It argues that when the authority at the top level is unambiguous and uncontested, there will be a unity of direction among subordinate managers and board members, due to clear, consistent, strong leadership and control, provided that the CEO-Chairman's duality of roles aims more to facilitate, empower, structure and enhance effectiveness and to produce superior returns to shareholders than when the posts are separated (Donaldson and Davis, 1991).

The following subsections present and discuss several corporate governance theories in detail.

3.1.1 *Legalistic View*

Primarily, this theory emphasises the role and function of the board of directors as duty of care and due diligence, and their effective implementation from a company law perspective (Zahra and Pearce, 1989; Johnson et al., 1996). In particular, the law requires firms to establish a board of directors whose members are bound by specific legal fiduciary duties, in other words, they are legally accountable for their actions and for the decisions they make on behalf of shareholders or stakeholders as a whole (Miller, 1993; Cieri et al., 1994; Johnson et al., 1996; DeZoort, 1998; Klapper and Love, 2004). For instance, their failure to conduct their duties appropriately or oversee and inform their client(s) of misappropriation in the corporation could expose them to a potential litigation suit (Borch and Huse, 1993; Blum and Hoeffner, 2006). Alternatively, directors that perform their fiduciary function well will be able to prevent

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management from indulging in unconstrained self-interested activities and hence reduce potential agency costs (Macey and O'Hara, 2003).

Primarily, directors accomplish their legal duties using the business judgement rule, which operates as the bylaw upon which their decision-making should be based (Johnson et al., 1996). It prescribes that directors make decisions on an impartial and informed basis, in good faith and with the best interests of the company in mind (Enriques, 2000). Providing that directors implement this guidance, they are protected against any liabilities that result from uncertainty in the business environment and other factors beyond their control (Manning, 1984; Johnson et al., 1996).

The business judgement rule also stipulates directors' duty of care and duty of loyalty (Budnitz, 1990 and Cieri et al., 1994). While the duty of care requires directors to exercise reasonable care, prudence and diligence in their dealings with the corporation's management (Macey and O'Hara, 2003), the duty of loyalty obliges them to act with an undivided and unselfish loyalty to the corporation and to restrain from indulging in conflicting dealings in relation to their duties and self-interest (Bogart, 1994; Macey and O'Hara, 2003). In the case of violation of any of these duties, directors may be penalised with liability suits to protect shareholders' interests. Nevertheless, these days, selective fair and/or arm's length self-interested transactions are allowed between directors and corporations such as in recognition of their benefit to the corporation and shareholders (Gordon et al., 2004). This activity is permissible provided the directors have obtained approval for given transactions from other informed board members (Enriques, 2000) or shareholders in a general meeting (Malaysia Securities Exchange Limited,

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2006) and make subsequent necessary disclosure in the annual report to inform the public about such activity (Mak et al., 2002; Malaysia Securities Exchange Limited, 2006).

In terms of board functions, the legalistic view emphasises the control and service duties of directors (Zahra and Pearce, 1989). Regarding the former, various studies have examined the impact of directors' oversight functions of CEOs' and top executives' management of firm performance (e.g. Juron and Loudon, 1966; Tosi et al., 1994; Huson et al., 2001). Regarding service duties, directors' advisory capacity has been linked with their non-executive position and outside experience. These aspects have been used to justify the reliability and credibility of their advice to the firm's management, their appointment as counsel to top management, and their involvement in the selection committee for the appointment and selection of the CEO and board members (Lorsch and MacIver, 1989; Johnson et al., 1996; Marens and Wicks, 1999). In addition, both roles have been examined in studies of corporate leadership (Berle and Means, 1932; Mace, 1971; Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983; Demsetz and Lehn, 1985; Dalton et al., 1998; Øxelheim and Randøy, 2003; Hutchinson and Gul, 2003).

Burkart and Panunzi, (2006) examined the effect of ownership type, that is, large shareholders and dispersed ownership and firm size on directors' performance of control and service roles. They found that board of directors presiding in family-owned and family-controlled firms perform their advisory and monitoring duties to monitor entrenchment activities by family members (i.e. private-rent seeking, not-arm's-length related party transactions and abuse of power), for the purpose of protecting minority shareholders' interests [Schleifer and Vishny, 1986; Boeker, 1992; Prowse, 1998; Claessens et al., 1999(a),(b); Mitton, 2002]. Owners are also

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likely to perform an active control function given their vested interest and empathy to preserve the family legacy (McConaughy et al., 1998; Anderson and Reed, 2003). Equally, even though smaller firms' boards may underperform in comparison to large firms' boards, nevertheless, they are active in the service role (Eisenhardt and Schoonhoven, 1990; Daily and Thompson, 1994; Yermack, 1996; Fiegner et al., 2000). However, as a firm's size increases, the firm's operations become more complex and this requires the board to become more actively involved in the control of the firm's management (Daily and Dalton, 1993). The legal theory anticipates the board's indirect contribution to strategic actions during performance of its monitoring and service role. Notably, its review and appraisal of managerial plans signifies its participation in the firm's strategic planning (Robinson Jr., 1982).

The theory also adopts a broader view of firm performance by considering a firm's financial, systemic and social implications (Zahra and Pearce II, 1998). In many cases, research has concentrated on the financial aspects of firm performance, especially on measures of shareholders' wealth creation, both accounting-based measures, such as the profitability ratio, and market-based units, such as share price and the market-to-book ratio (Klein, 1998; Vafeas, 1999; Joh, 2003). Alternatively, researchers have investigated firm performance in terms of a firm's survival and growth potential (Baysinger and Butler, 1985; Kole and Lehn, 1997; Certo et al., 2001; Filatotchev, and Toms, 2003). As regards to a firm's social performance, the theory has been employed to examine the board's stance on and involvement in corporate social responsibility (Coffey and Wang, 1998).

3.1.2 *Resource Dependency View*

In resource dependency theory, the board of directors is viewed as an integral component that can effectively connect the firm to the external environment (Boyd, 1990). In particular, board members' association with certain organisations and/or interlocking directorships is valuable in facilitating, securing and easing the process of acquiring and accessing scarce and essential resources (Selznick, 1949; Zald, 1969; Pfeffer and Salancik, 1978; Penning, 1980; Galaskiewicz, 1985; Zahra and Pearce, 1989; Kesner and Johnson, 1990; Scott, 1991; Mizruchi & Galaskiewicz, 1993; Daily and Dalton, 1993; Goodstein et al., 1994; Johnson et al., 1996; Kula, 2005). Indeed, it is anticipated that the image of both the organisation and its leaders will reflect one another's accomplishments, such that competent leaders are expected to lead to organisational success and their credibility depends on their ability to fulfil organisational goals (Hambrick and Mason, 1984; Sutton and Callahan, 1987). Further, according to Salancik and Meindl (1984), the external constituents' faith in top managers' abilities and continual support are influenced by a firm's financial performance.

According to Boyd (1990), there are two major factors that influence board composition, namely, the external environment and the need to improve and maintain firm performance. In terms of the former, Gomez and Jomo (1997) argue that the presence of incumbent and/or retired government officers (who are members of the ruling party) on the board of directors of public firms has an effect on firms' access to government projects. Additionally, Stearns and Mizruchi (1993) found that, in the US, the type of financial institutions' representatives on large manufacturing firms' boards of directors has a significant impact on the type and amount of financing the firms can obtain. Hillman et al., (2000) also identified a significant association

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between board composition and the changing resource dependency needs of US airlines undergoing deregulation.

As regards with the latter, Kaplan and Mitton (1994) observed the appointment of corporate and financial directors to the board of large Japanese corporations is motivated by the need to improve previous poor performance. Sutton and Callahan (1987) indicated in their studies of firms facing or emerging from a bankruptcy crisis (after filing for Chapter 11 of the Federal Bankruptcy Code) that, to survive from past failure, it is important to restore relationships with particular constituencies. Apparently, the extent of a firm's need for environmental linkage determines its level of dependence on other organisations (Boyd, 1990).

In terms of a firm's human capital needs, the theory emphasises the importance of the extent of top managers' knowledge of a firm's resources. Various researchers have emphasised the merits of managers that can potentially utilise a firm's resources and capabilities for superior resource allocation decisions (Penrose, 1959; Kesner and Johnson, 1990; Daily and Dalton, 1993; Goodstein et al., 1994; Kor and Mahoney, 2005). Evidently, managers' unique organisational skills and abilities give a firm a competitive advantage to generate more rents than other firms (Castanias and Helfat, 1991). Strategically, such key internal resources determine managers' effective management of a firm's opportunities (Penrose, 1959) and the generation of superior rents from the efficient use of superior or scarce resources (Castanias and Helfat, 1991). Specifically, Kor and Mahoney (2005) discovered that managers' knowledge and experience of a firm's products and technology are significant in the reliable management of logistic systems, which extend to sustaining long-term firm-client relationships and satisfaction. Similarly, studies

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by Katz (1974) and Hampton et al., (1987) on the nature of top management identified the inherent traits and skills of top managers that determine effective leadership.

Despite the above, the theory neglects the issue of agency problems arising within a firm, given the separation of ownership and control of the firm and the role of top executives as rent generators from the deployment of their traits, managerial and leadership skills for shareholders (Castanias and Helfat, 1991). For firms, overlooking this issue when making a resource allocation plan may jeopardise the assessment and innovative decision-making process of resource deployment and capability (Penrose, 1995; Kor and Mahoney, 2005).

3.1.3 *Agency Theory*

An agency relationship signifies a contract between the principal that is, the owner, and the agent, that is, the manager, of a firm, whereby the principal delegates some authority to the agents to perform a service on his/her behalf (Gay, 2002). Ideally, the fulfilment of this contract would require the agent to manage the owner's investment in the same way as a sole proprietor or partners of a private company would (Hart, 1995).

However, according to Adam Smith (1776), managers cannot be expected to oversee the business undertaking with the same vigilance as owners themselves. Thus, the separation of firm ownership and control could increase the power of professional managers and create a conflict of interest between owners and managers (Muth and Donaldson, 1998). These factors, combined with a poor internal monitoring mechanism, are likely to cause managers to pursue economic objectives that may be contrary to the owner(s)' profit maximisation goal (Masson, 1971; Ross,

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1973; Jensen and Meckling, 1976). Also, the information asymmetry between owners' and managers' knowledge about the internal operations and management of the firm due to owners' lack of direct participation in the firm's management and access to inside information may result in adverse selection and moral hazards (Chrisman et al., 2004). To some extent, adverse selection will affect the principal-agent contract when the principal engages less committed and incompatible managers. Moreover, moral hazard actions by managers, such as shirking, unfounded rewards and unwarranted acquisition activities, are detrimental to the principal's investments (Edlin and Stiglitz, 1995; Avery et al., 1998).

Regarding the tendency for the agency problem to arise in separately owned and controlled firms, Fama and Jensen (1983: 304) contend this occurs when the contract between the risk-bearer, that is, the owner, and the decision-maker, that is, the manager, lacks appropriate enforcement. They further add that it is necessary to monitor the decision-making process of managers who are not residual claimants so that shareholders are well-informed and aware of the wealth effects of managers' actions on their investment. This is because a lack of control implementation by owners could leave managers' opportunistic behaviour undetected (Galbraith, 1967; Demsetz and Lehn, 1985). The use of a disciplining mechanism is crucial when managers' compensations are not linked to firm performance and /or share ownership in the firm (Jensen and Murphy, 1990).

Although direct monitoring by owners permits a close scrutiny of managers' activities, its implementation is costly and may create a free-rider problem (Hart, 1995). On the other hand, incentives and reward schemes that compensate managers at a level similar to that of the

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owners, such as bonus-pay and share option compensation schemes may motivate and redirect managers to pursuing shareholders' value creation (Ofek and Yermack, 2000). In addition, the role of the board of directors as an important internal mechanism for safeguarding shareholders' interests has been widely discussed. Firstly, the board has a responsibility to monitor and oversee shareholders' interests given its legal authority, access to firm information, and contact with senior managers (Johnson et al., 1996; Subrahmanyam et al., 1997).

Moreover, the presence of independent outside directors on the board enhances the board's effectiveness in managing competition among top managers (Fama, 1980), providing objective and unbiased views (Baysinger and Butler, 1985), monitoring fairly decision-making at the top level (Fama and Jensen, 1983; Lee et al., 1992) and establishing a fair representation for minority interests (Johnson et al., 2000). The board's significance as the shareholders' 'watchdog' is increased by its independence and separation from the influence of the management team. However, outside directors' independence from management power has resulted in their ineffectiveness in challenging the CEO's decisions, due to the latter having control and influence over their appointment, remuneration and term of office (Daily and Johnson, 1997; Shivdasani and Yermack, 1999; Mohammad Abdullah, 2003). More discouragingly, Monks (2001) found American law does not require shareholders to approve the compensation scheme set for executives. Independent directors' main purpose is further disturbed when they assume the directorship position as a means of associating with a prestigious group and/or attaining covert privileges (Monks, 2001).

For decades, research on agency problems has focused on the issue of firm ownership, namely small, dispersed and concentrated ownership. For instance, Berle and Means (1932) found

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evidence of managerial entrenchment in 200 non-financial firms in the US that were owned by a large number of small shareholders. Later, Morck et al., (1988) found higher levels of insider ownership caused further entrenchment by incumbent managers. According to Stulz (1988), initially, managerial ownerships will align their interests with those of shareholders, however, as managers' share ownership rises to the point of them gaining control of the firm, managerial entrenchment will prevail and affect the firm's value (Sundaramurthy et al., 2005).

Studies on agency costs in concentrated ownership firms have been extended to include family-controlled firms (for instance, Allen and Palian, 1982; Boeker, 1992; Claessens et al., 1999). Jensen and Meckling (1976) and Fama and Jensen (1983) contend that owner-managed firms provide a solution to the conflict of interest in firms with dispersed ownership. A family business is often held together by strong kinship obligations or feelings of altruism between its members (Stewart, 2003). It is therefore believed that this binding normative moral order can mitigate some agency costs, given that property rights are restricted to internal decision agents (Schulze et al., 2002). However, family relationships may create agency problems unique to family businesses, such as free-riding by family members (Bruce and Waldman, 1990; Prowse, 1998; Mitton, 2002; Morck and Yeung, 2004), ineffective family-member managers (McConaughy et al., 1998), and managers bypassing minority shareholders' interests under orders from the controlling family [Johnson et al., 2000 (b); Morck and Yeung, 2003].

3.1.4 *Managerial-Class Hegemony*

Managerial-class hegemony theory posits that, professional managers dominate the strategic management of the firm, with the board of directors performing more of a supporting function

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(Hung, 1998). As the situation prevails, the board becomes less active in setting strategies (Whisler, 1984) due to members being prevented from becoming involved with this task (Lorsch, 1989). Further, the board's involvement in the strategic management of the firm will be contingent upon the firm facing a crisis (Mace, 1971; Clendenin, 1972). Moreover, given that the appointment and selection of directors are subject to the managers' discretion, directors may be pressured to conform to managers' decisions to secure their post. In addition, with the accessibility and availability of information to the board of directors controlled by and reliant on managers' cooperation, such boards are restrained from making effective independent and informed decisions due to lack of the required and relevant knowledge (Hung, 1998). Specifically, this theory describes managerial entrenchment behaviours in agency theory.

3.1.5 *Stakeholder Theory*

Stakeholder theory presents the idea of a corporation as an organisational entity connected to numerous and various participants, and circumstances requiring them to accomplish multiple and not necessarily congruent purposes (Freeman, 1984; Donaldson and Preston, 1995). Freeman (1984:46) defines a stakeholder as "*any individual or group who can affect or is affected by the achievement of the organisation's objectives*". Thus, the nature of the relationship between vested parties has implications for both the firm and its stakeholders. The theory also highlights the potential intrinsic value of the vested parties and debates the possibility of the firm favouring the interests of one group over those of another (Jones and Wicks, 1999). Donaldson and Preston (1995) nevertheless point out that managers have the responsibility to select activities and direct resources to obtain benefits for all legitimate stakeholders. The terms of the contract signed between the firm and vested parties should determine who are the legitimate stakeholders and therefore the firm's direct contributors.

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Studies on corporate social responsibilities¹⁸ have explored the link between a firm's concentration on implicit claimants' interests (that goes beyond the interests of its shareholders and bondholders) and their subsequent economic benefit. For instance, McGuire et al., (1988) found that firms with low social responsibility experienced lower returns on assets and lower stock market returns than firms that practised better social responsibility. In another study, Turban and Greening (1997) reported firms with a higher corporate social performance rating having a competitive advantage to attract more applicants due to their positive reputation and prospect as superior employers than those with a lower rating.

Amongst others, stakeholder theory has broadened the scope of a board of directors' responsibilities to include the interests of numerous stakeholders (Freeman, 1984). In examining this, Wang and Dudley (1992) focused on the corporate social orientations of the board of directors in 291 public firms. They found directors are conscious of their responsibilities to customers, the government, employees and the society. In particular, CEO-directors were concerned more about issues relating to customers' needs and expectations and laws than non-CEO directors, who concentrated on issues associated with shareholders. On the other hand, the presence of stakeholder representatives on the board of directors does not necessarily result in the setting up of a strategy by the firm that will improve the firm's stakeholder relations and stakeholder performance (Hillman et al., 2001). The effects of stakeholders' interests on stakeholder performance will vary, depending on (i) the influence of the aforementioned parties, (ii) the effectiveness of stakeholder board members, and (iii) targeted stakeholder performance.

¹⁸ including employee and customers' goodwill schemes, charitable contributions, promoting community development plans and establishing environmental protection procedures

3.1.6 *Stewardship Theory*

In contrast to agency theory's economic approach to governing individuals' opportunistic behaviours, stewardship theory promotes sociological and psychological means of overseeing subordinates' actions. It views people in an organisation as possessing a collectivist, pro-organisational and trustworthy quality (Davis and Donaldson, 1997). Muth and Donaldson (1998) add that managerial behaviours are not necessarily driven by financial motives. To some extent, managers need to be given a certain degree of authorisation and discretion to ensure the business is effectively managed in the best interests of its shareholders. Also, again in contrast to agency theory, stewardship theory does not regard the existence of separate ownership and control as a setback given managers' preference for cooperative behaviours over self-serving motives (Davis et al., 1997; Donaldson and Davis, 1991; Gay, 2002) and their wide range of motives and behaviours (Muth and Donaldson, 1998).

Fama and Jensen [1983(a)] posits that, in a large corporation, the greater influence of inside board member managers than of outside directors is to be expected. They argue this is because these executives have valuable specific information about the organisation's activities. According to Clarke (2004), stewards' contributions to firm performance extend to consideration of psychological, social, cultural and situational dimensions. From the psychological perspective, managers will be induced to attain a higher level of performance when their task significance and empowerment are increased, and greater job satisfaction will be achieved. However, from the social perspective, managers identify themselves as representatives of the organisation and regard their power as an instrument to influence others to accomplish valid and accepted organisational goals.

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Additionally, from the situational perspective, managers are expected to perform better in an involvement-oriented environment where the thinking, controlling and accomplishment of duties are combined into one task. Moreover, where the firm's culture is directed to collectivism orientation, this will further pressure of managers' loyalty to and long-term relationship with the firm (Clarke, 2004).

In terms of board of directors' effectiveness, the theory supports the insider-dominated board primarily because of executives' depth of knowledge, access to current operating information, technical expertise and commitment to the firm (Muth and Donaldson, 1998). In addition, relinquishing control of the board to a Chairman who is also the firm's CEO, will give consistency to the firm's control and leadership (Donaldson and Davis, 1991). Consequently, these aspects are predicted to have a significant impact on shareholders' value maximisation.

3.2 Conclusion

This chapter has reviewed the diverse perceptions of several corporate governance theories regarding the roles and functions of boards of directors in firms and the link between their attributes and their capability to accomplish their fiduciary duties. For instance, from the legalistic theory point of view, directors are obliged to demonstrate they represent the interests of shareholders and the firm because company law legally binds and obliges them to fulfil their stipulated duties to the firm. On the other hand, resource dependency theory concentrates on the benefits that directors bring to the firm, whether in terms of leadership skills, business knowledge and experience and/or business contacts. Importantly, due to the uncertainty of the business environment, such assistance is expected to improve the firm's reputation and future viability and give it an advantage over others. Stakeholders' theory extends the range of a firm's

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potential vested interests beyond those of its shareholders to include employees, suppliers, customers, the government, environmentalists, the public, and so on.

Agency theory claims that when the owners of firms employ other people, that is, managers, to run their business, this situation can potentially create a conflict or agency problem between two parties due to their disparity of interests. In contrast, stewardship theory posits from a psychological perspective that managers will be driven to perform the benefit of the company when they are given significant responsibilities and empowerment, as these enhance their job satisfaction and self-actualisation. The review of the theories has also identified three theories that are pertinent for elucidating the corporate governance environment and circumstances in the Malaysian context, namely, legalistic theory, resource dependency theory, and agency theory. The next chapter focuses on the roles of boards of directors and boards' subcommittees.

Chapter 4

Literature Review II:

~ Board of Directors' and Their Subcommittees' Roles in Corporate Governance Practice ~

4.0 Introduction

The previous chapter has discussed several corporate governance theories with regard to the effect of directors' contributions and the fulfilment of their duties on firm performance. This chapter explains in detail the monitoring and controlling, service and strategic roles of Boards of Directors and describes board attributes, namely, composition, structure, characteristics and processes, and their implications for the fulfilment of board members' duties. In addition, the role and functions of the board's subcommittees, namely, audit, nomination and remuneration committees are examined at length. The chapter then focuses on market value and accounting-based measures of financial performance.

4.1 The Roles of Board of Directors

The formation of a board of directors in a corporation is important as an internal control mechanism to oversee the conduct of the owner-manager and managers and prevent them from endangering vested parties' interests (Hermalin and Weisbach, 2003). Even though some of its responsibilities may have been delegated to firm managers, decisions relating to company policy and strategies' planning, their set up and implementation, and the

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appointment, dismissal and compensation of executives are ratified and determined ultimately by the board [Fama and Jensen, 1983 (a)].

In order to protect shareholders' interests appropriately, it is imperative for the board of directors to play a vigilant protector role (Buchholtz et al., 2005). Broadly, the board of directors' duties have been examined in terms of their monitoring, service and strategic planning roles (Mace, 1971; Baysinger and Butler, 1985; Andrews, 1987). Importantly, to ensure and sustain firms' competitiveness and strategic alliances, firms' boards need to be effective and efficient (Thain and Leighton, 1992; Ibrahim and Angelidis, 1995). In succeeding subsections, these roles are explained in greater detail.

4.1.1 *Monitoring and Controlling Roles*

A board's monitoring and controlling roles include evaluating company and CEO performance (Hermalin and Weisbach, 2001) such that it can be guaranteed that the business has been properly managed (MCCG, 2001) and managers' conduct is in keeping with shareholders' value creation and corporation growth (Uzun et al., 2004). The board's functions also encompass designing compensation contracts, reviewing management succession planning in relation to the hiring and firing of CEOs (Walsh and Seward, 1990), replacing senior management and evaluating the integrity of the company's internal control systems and management information systems and their compliance with the stipulated laws, regulations, directives and guidelines (MCCG, 2001:11)

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4.1.2 *Service Roles*

Directors' service roles have been interpreted in terms of their function of providing advice and counselling to the management team (Conyon and Peck, 1998). Specifically, this consists of advising management on the selection, compensation and dismissal of top managers (Shivdasani and Yermack, 1999). In addition, Baysinger and Butler (1985) emphasise independent directors' roles in evaluating management strategies and management progress in accomplishing set objectives and subsequently their impact on firm performance. Outside independent directors' non-association with firm management and freedom from management influence make them appropriate arbiters in resolving internal managers' disputes and carrying out duties regarding agency problems [Fama and Jensen, 1983(a)].

4.1.3 *Strategic Roles*

Over time, directors' involvement in the setting of the firm's strategies has been insisted upon (Forbes and Milliken, 1999; Gendron et al., 2004; Turley and Zaman, 2004). Whereas in the past, their participation in and concentration on this duty have been passive (Pfeffer, 1972; Tashakori and Boulton, 1983; Mallin, 2001), it is now believed directors' proactive involvement in the corporate planning team can enhance the company's and management's credibility (Robinson Jr., 1982). In particular, their challenging enquiries aimed to clarify and justify management's proposals, policies and decision-making, and their taking a firm stance regarding the imposition of fair, appropriate and sufficient monitoring measures can benefit a firm (Ireland and Hitt, 2005).

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4.2 Board of Directors' Attributes

According to Zahra and Pearce (1989), examining board members' attributes helps to discern their direct and/or indirect contributions to firm performance. Notably, there are four main attributes that have been widely examined: board composition, characteristics, structure and processes. The succeeding subsections elaborate upon each of these attributes.

4.2.1 *Composition*

Board composition describes the number of directors on a firm's board and the distinct type of directors on the board, for example, whether they are inside or outside directors. Outside directors represent those who are not members of top management (Fosberg, 1989), their associates or families (Shivdasani, 1993), employees of the firm or its subsidiaries (Abbott et al., 2000) or members of the immediate past top management group (Rhoades et al., 2000). 'Outside director' is also the term given to an independent non-executive director who has no affiliation with the firm other than the affiliation derived from being on the firm's board of directors (Beasley, 1996). Another director category is a 'grey' or 'affiliated' director who is not an employee but may not be independent of management due to their business dealings with the company or family association with the management (Weisbach, 1988; Daily and Dalton, 1994; Hillman et al., 2000).

Issues relating to the presence of minority groups on the board, such as ethnic groups, and gender distribution on boards of directors have also been explored to examine their impact on board performance (Zahra and Pearce, 1989; Haniffa, 2003).

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4.2.2 *Characteristics*

Mainly, board characteristics can be divided into two categories: background and qualities. In terms of background, research has examined directors' ages (Taylor, 1975; Beatty and Zajac, 1994), educational levels (Schroeder et al., 1967; Wiersema and Bantel, 1992), ethics (Bommer et al., 1987), and work experience (Wagner et al., 1984). Directors' qualities have been linked to their individual and/or collective characteristics and the 'personality' of the board (Zahra and Pearce, 1989). For instance, studies have been carried out to observe directors' style of management in relation to their concentration on internal and external issues (Pearce, 1981), shares ownership in firms (Connell and Servaes, 1990), and the setting of strategies (Kets De Vries and Miller, 1986).

4.2.2.1 **Board of Directors' Knowledge and Skills**

Generally, the link between board of directors' knowledge and skills with their job performance can be explored in relation to Bonner and Lewis's (1990) categories of experts' knowledge and skills, namely, general domain knowledge, subspecialty knowledge, and world knowledge.

4.2.2.1.1 **Domain Knowledge**

In particular, they defined general domain knowledge as instruction and experience acquired from working in a particular domain. For Einhorn (1974) such knowledge reflects the ability of a person to construct complex interactions and to discern, form and elucidate distinct courses of actions. Studies in psychology have explored experts' and novices' general domain knowledge in terms of their strategies formulation, retrieval of related information, scope of knowledge and

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problem solving abilities¹⁹. For instance, domain knowledge of auditing technical knowledge would represent the person's medium knowledge of auditing tasks (DeZoort, 1998).

4.2.2.1.2 Subspecialty Knowledge

On the other hand, subspecialty knowledge while similar to domain knowledge is the acquisition of the knowledge from formal instruction and experience in the work environment (Bonner and Lewis, 1990). However, in terms of the focus of its contents, it is knowledge in a subspecialty area such as derivative contracts (Tan and Libby, 1997). Lipton (2006) argues that the nomination committee has the responsibility to make sure that the board of director members appointed possess relevant industry and business knowledge of the firm. Lee et al., (1999) found that outside directors who work in the financial industry and possess specific financial experience, namely, commercial banking and insurance and investment management experience, have a positive impact on firm abnormal return. Particularly, their appointment to the board of small firms assists companies' access to financial markets.

In addition, many Securities Commissions and Stock Exchanges require listed firms to appoint at least one board member with financial knowledge and skills (see Schleifer and Vishny, 1997; La Porta, et al., 1998, 2000; OECD, 2002; Sarbanes Oxley Act 2002; PwC, 2003). Underlying this requirement are the board of directors' oversight duties to ensure that listed issuers have complied and conformed to the relevant accounting standards and regulations when preparing financial reports (MCCG, 2001). Its effective implementation is critical, which further requires

¹⁹ For instance Chase and Simon (1973) cross-examined chess masters and novice players' game board skills and Chi et al., (1982) investigate the physicists accuracy in solving physics problems based on physics principles.

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board members to be objective, vigilant and accountable particularly when performing their financial oversight duties (DeFond and Francis, 2005; DeDond et al., 2005). To ensure the accomplishment of credible and quality evaluation and the production of an accurate financial statement, it is necessary for the board of the firm to comprise individuals with relevant and related financial and accounting knowledge and expertise (Buckley and Van Der Natt, 2003)

For instance, financial experts are noted for their greater ability to evaluate appropriately the financial information and circumstances presented by the management (see, for example, Kirk and Siegel, 1996; Blue Ribbon Committee, 1999; Kirk, 2000). In particular their relevant knowledge and skills make them effective appraisers of the firm's financial feasibility (see DeZoort and Salterio, 2001). Also, their accounting experience and skills will assist in the detection of creative accounting activity, such as earnings management (Agrawal and Chadha, 2005).

Moreover, Dionne and Triki (2005) report that the presence of independent directors with financial knowledge and skills enhances evaluation of management resolutions' impact on shareholders' wealth. Their absence limits board of directors' active participation in the evaluation of management derivatives plans (Buckley and Van Der Natt, 2003). Consistently, Booth and Deli (1999) and Guner et al., (2004) found that, directors with a commercial banking background are able to assist the firm in managing the financing options of its debts. Despite their relevant knowledge, financial experts' effective performance requires them to be objective, vigilant and accountable when performing the oversight responsibilities (DeFond and Francis, 2005; DeFond et al., 2005).

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The company secretary is also an important human capital to the board of directors as well as board subcommittees (Higgs Report, 2003). In particular the company secretary is recognised for his/her extensive knowledge of the firm's business procedures, board training and induction programme, legal requirements, corporate governance and best practice developments (see Para 11.30 Higgs Report 2003). Taking this into account, the secretary's knowledge and experience of the firm's operational and financial procedures will be valuable in assisting outside directors to obtain relevant information from the appropriate person and source in and outside the firm (ICSA, 2005).

Moreover, the Institute of Chartered Secretaries and Administrators (ICSA) further encapsulates the responsibilities of the company secretary to comprise knowledge of:

- Governance structures and mechanisms
- Corporate conduct within an organisation's regulatory environment
- Board, shareholder and trustee meetings
- Compliance with legal, regulatory and listing requirements
- The training and induction of non-executives/trustees
- Contact with regulatory and external bodies
- Reports and circulars to shareholders/trustees
- Management of employee benefits such as pensions and employee share schemes
- Insurance administration and organisation
- The negotiation of contracts
- Risk management
- Property administration and organisation
- Interpretation of financial accounts

(Source: ICSA, 2007)

The company secretary's experience in handling the firm's documents and business procedures will further help outside director acquisition of relevant internal and external information about the firm and hence to make better informed judgements. Whilst, the appointment of directors

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with a legal background will enhance board of directors' understanding of the legislative and regulatory rules and procedures (Baysinger and Butler, 1985; Verschoor, 1993).

4.2.2.1.3 World Knowledge

Another form of expert knowledge, world knowledge, refers to the knowledge obtained from the individual's general life experience which is not specifically acquired from training or experience in a domain, such as general problem solving ability (Bonner and Lewis, 1990:4). Such knowledge may have been acquired from a person problem solving experience. For instance, in the case of an auditor- management dispute, the experience that a company director has as independent director or director of a company or member of senior management will influence his/her independent judgement (DeZoort and Salterio, 2001).

Directors who are commercial bankers can further advise firms on making decisions and managing their financing options in relation to their current debt circumstances (Booth and Deli, 1999; Guner et al., 2004). Moreover, the practice of creative accounting such as earnings management, can be prevented by the detection of such conduct by directors who have in-depth knowledge of accounting and financial management (Agrawal and Chadha, 2005).

As well as financiers and consultants, Baysinger and Butler (1985) noted the importance of lawyers in providing advice and counsel to inside managers.

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4.2.3 *Structure*

In terms of board structure, extensive study has been made of the leadership structure in firms, types of board committees formed in firms, the make-up of board committees' membership, and the flow of information among board committees in corporations (Zahra and Pearce, 1989). In particular, studies on the leadership structure of boards in small corporations²⁰ by Daily and Dalton (1993) indicated that when founders of the firm are active in its management, they are likely to hold the position of CEO as well as chairmanship of the board.

Goyal and Park (2002) further found that when the firm's CEO is also the Chairman of its board, the board's monitoring role may be impaired. In addition, the formation of board committees, such as the audit committee, increases the board's involvement beyond its legitimising role such that it extends to the appraisal of the accuracy of information produced by management (Boulton, 1978). Harrison (1987) also contended that the formation of audit, nominating and remuneration committees as monitoring and oversight committees is significant to protect shareholders' interests. This is because these committees will provide objective and independent reviews of corporate affairs that will take into account the legality, integrity and ethical aspect of corporate activities.

4.2.4 *Processes*

This category details the board of directors' approach to and extent of participation in a firm's decision-making process. These include the frequency and duration of a board of directors' meetings, a board's proceedings, a board's evaluation, and consensus amongst board members.

²⁰ Firms with 500 or less employees and sales turnover not more than USD 20 million per year

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Notably, studies on board processes have focused on the impact of these activities on firm performance and the board's effectiveness (Pye and Pettigrew, 2005). A board that is active and independent of management will contribute to and facilitate a higher return on investors' investments (Millstein and MacAvoy, 1998). In exploring board processes, Pettigrew (1987) observed that internal aspects, i.e. a firm's structure, culture, power and political characteristics, and external aspects (i.e. industry sector, economic, social and political influence of the organisation have a potential bearing on the conduct and role of the board of directors).

4.3 The Significance of Independent Outside Directors

To understand the influence of board behaviours, effectiveness and dynamics, research has focused on the roles and contributions of different directorial types of individual board members, namely, the executive, non-executive and independent non-executive director. It has been reported that the extent of board members' direct and indirect influence on firm's governance has implications for their effectiveness and involvement (Long et al., 2000). The efficacy of the board as the firm's ultimate decision-making control is crucial to its ability to monitor and control the discretions of top-level managers [Fama and Jensen, 1983(a)]. The board's dependence on managers to supply them with the firm's internal information (see Ezzamel and Watson, 1997) emphasises the importance of ensuring managers practising the same monitoring considerations as the board.

Notably, non-executive directors are perceived as significant long-term and impartial decision-makers and monitors of the governance process (Tricker, 1978; Higgs, 2003). From a corporate governance perspective, their separation and independence from management and any

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relationship that may potentially interfere with their independent judgement and fair representation of shareholders' interests, emphasise their suitability as a reliable governing mechanism and their potential ability to concentrate on ensuring maximisation of shareholder value (Beasley, 1996). Similarly, their selection from people outside of management and free from any business relationship with the company, enhances their objectivity and independence, enabling them to provide unbiased views and judgement, to act in the best interests of shareholders, and to represent fairly their investment in the company (BRC, 2005).

The conflict of interests between owners and managers in separately controlled and dispersed ownership firms and the entrenchment of minority interests by major shareholders and owner-managers in concentrated ownership firms has created agency problems. As outside parties that are free from association with management, outside directors' involvement in the board proceedings is essential to minimise agency costs, especially when credible and vigilant monitoring duties are practised (Beasley, 1996). In other words, they should be able to perform monitoring tasks effectively and have fewer incentives to collaborate with management in expropriating a firm's assets. Further, the board of directors is the highest internal control mechanism for monitoring top management's conduct in a firm (Beasley, 1996), hence underscoring the importance of the participation of independent individuals of calibre in board monitoring, and in a firm's advisory and strategy-setting activities.

Helland and Skyuta (2005) also suggest that, in order to motivate the monitors to perform their duties efficiently, their roles and incentives need to be aligned. Independent directors' board membership gives them the opportunity to hold a prestigious position, improve their reputation,

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gather further business experience, and expand their networking (Lorsch and MacIver, 1989; Srinivasan, 2005). Fama and Jensen (1983) contend that outside directors have the incentive to build reputations as expert monitors. Also, their external experience will supplement inadequate skills in both strategic processes and the setting of plans (Robinson Jr., 1982). However, given the global acceptance and adoption of the code of corporate governance and best practices, commonly by Stock Exchange listing rulings and Securities Commission policies, outside directors' failure to perform their oversight duties effectively may impair their reputation in the future (Abbott et al., 2003; Lee et al., 2004; Srinivasan, 2005).

Significantly, independent directors are viewed as people who can provide a better quality and assurance of reasoned corporate judgement (Ferris et al., 2003), whereas managers, who have to face the pressures of day-to-day events, may overlook some of the decisions made and/or avoid making risky choices (Firstenberg and Malkiel, 1980). Nevertheless, having general wisdom alone is not sufficient for independent directors to contribute productively. They need to be competent and capable of understanding the firm's business operations. In particular, the Combined Code (1998) emphasises non-executive directors should be those who possess sufficient calibre. This attribute is important for them to be able to influence board directions and decisions effectively and to ensure the implementation of plans that take into account the long-term interests of various shareholders, and the appropriate management of firm risk. In addition, Libby and Luft (1993) and DeZoort (1998) claim that, appointing directors with related and relevant skills and the knowledge to perform task-specific duties, such as the evaluation of the firm's internal control and accounting procedures, will enhance the quality of information

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gathered, of the solutions to problems, and of the views held and judgements made during the decision-making process.

As indicated by Fairchild and Li (2005), outside directors with a variety of specialist knowledge will be valuable to the creation of a strong and informed board, in particular in justifying their views on and concern with management propositions. Moreover, according to Dionne and Triki (2005), board members from a non-financial background contribute by extending the company's viewpoint and prospects on particular issues in terms of the broader context of the industry and business perspectives. The aforementioned advantages support a firm's decision and strategy to include on its board of directors individuals with a mixture of skills, knowledge and experience in specific and a broad range of industries and from financial and non-financial backgrounds. Moreover, by having board members with a diverse range of expertise, the firm strengthens its human capital competitiveness (DeZoort, 1998; Kor, 2003; Kor and Mahoney, 2005).

In addition, outside directors' effectiveness is enhanced when large numbers of them are involved in the board's nomination process and meetings agenda since they can provide appropriate control over the deliberation process. To some extent, the board's mission, composition and views are affected by their attitude towards and fulfilment of their governing responsibilities. Above all, independent directors' inclusion in the nomination committee will ensure board members are chosen for their quality and experience (Shivdasani and Yermack, 1999). Extending their authority to include the dismissal of inefficient directors will further improve their independence purpose (Borokhovich et al., 1994).

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A united group of independent directors who are prepared to challenge management when they should can be nurtured. For instance, Weisbach (1988) found that boards dominated by outside directors are likely to replace a poor CEO. One reason is that their incentives differ from those of inside directors, given that the career security of the latter is under the CEO's control. Another reason is that poor performance reduces the credibility of the CEO as an expert in decision-making (Fama and Jensen, 1983). Thus, outside directors' involvement in the selection of a new CEO is influenced by their need to enhance their reputation by employing a competent candidate, according to Borokhovich et al., (1994). They further indicated that outside directors are likely to choose an external candidate rather than an internal CEO since their external exposure and contacts will have equipped them with a broader view of the candidate options. Moreover, they observed a positive reaction to share returns when an external candidate is chosen to replace an underperforming CEO.

It is also crucial for independent directors to play an active role in determining the agenda of meetings to establish a commanding independent voice on the board and to ensure vital issues are addressed appropriately. In particular, the focus of discussions and progress of meetings can be oriented to cover and assess independent directors' main issues or areas of concern. In addition, given the time consumed by and the potential liability associated with a director's job, both the appointment of accomplished board members and their performance are affected by the attractiveness of their remuneration package. Independent directors who are not committed to fulfilling their duties will not be effective due to the substantial time needed and to learn about and keep themselves abreast of the development of the company's business (Lee et al., 2004). Thus, dedicated directors should not hold more directorships in other companies than would

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allow them to cope with their responsibilities or that would be likely to harm their job performance. Accordingly, the review of board performance, specifically by peer review, ensures the appropriate disciplining and assessment of each director's achievement (Ferris et al., 2003).

Further, independent directors' roles need to be supported by the advice of internal and external experts, with the latter being the crucial points of contact. This is vital to achieve objective, appropriate and informed decision-making. Without management acknowledging the benefit of sharing the company's governance process and collaborating with the directors, hiring competent directors will not necessarily result in effective board performance or in value being added to the company. Management therefore needs to accept, invite and encourage directors to participate actively in the area they are good at and provide them with the information they need to facilitate the performance of their duties. The bargaining position of the CEO in relation to directors also has an effect on the board's conduct over time (Hermalin and Weisbach, 2001).

4.3.1 *Majority Presence of Independent Directors on the Board*

In this section, the implications and influences of independent directors are examined, particularly in terms of their impact on the fulfilment of board responsibilities and proceedings. An empirical investigation by Cotter et al., (1997) into 169 tender offers in US target public firms from 1989 to 1992 highlighted the significant and distinctive governing characteristics of outside directors. In particular, even though under normal circumstances independent directors may be reluctant to accept tender offers, as this may have consequences for the terms of their directorship, nevertheless, given the circumstances, they will ensure shareholders secure higher

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gains by demanding both higher initial tender offer premiums and higher bid premium revisions. Moreover, the independent stance of outside directors allows them to function as appropriate and unbiased mediators to resolve disagreements between management and shareholders.

With regard to stock price reaction to corporate anti-takeover amendments, the evidence gathered by McWilliams and Sen (1997) indicates that when the board is dominated by insiders and affiliated outside directors, the firm is likely to experience a negative return. Seemingly, the market perceives management re-statement of anti-takeover policies as a means of increasing their veto power in takeover bids. In contrast, when the board is dominated by independent directors, the market views this as a positive move towards effective monitoring of management actions since the board ensures the amendment is set up and used to the benefit of shareholders. However, the majority presence of insiders and/or affiliated outside directors is seen by the market as detrimental as directors may deploy such amendments to retain their control at shareholders' expense.

Beasley's (1996) study on the relationship between the presence of outside directors and the occurrence of financial statement fraud, involving 75 companies with and without cases of fraud, indicated that boards of companies with no incidents of fraud comprised a significant number of outside directors. Beasley found the governing function of outside directors was further enhanced by the increase in their share ownership, the length of their term of office, and the reduction in the number of directorships in other companies. Lee et al., (1992) showed that outside directors have the tendency to ensure shareholders' wealth interests are accounted for appropriately in the case of a management buyout attempt. They claim that, in this situation,

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such directors acted by forming independent committees with the necessary capabilities and competencies to examine properly the implications and feasibility of the company's performance to ascertain shareholders' value creation. In Kosnik's (1987) attempts to observe management greenmail (i.e. a company's private repurchasing of its stock at a premium) above-market price, he noted that the boards of firms with a higher percentage of independent directors were more resistant to such a management resolution. He concluded that such directors have a greater commitment to challenging managerial decisions that can erode shareholders' investment viability.

Shivdasani and Yermack's (1999) study on directors' employment in 500 Forbes firms between 1994 and 1996 indicated that CEO involvement in the directors' selection process has an impact on the nature of the appointment of board members. When the CEO takes part in the selection process, the firm selects directors who are less likely to monitor aggressively. In particular, the company employs grey directors, as these are less likely to insist on a majority of independent directors on the board due to their potential interest in the firm. In addition, when the CEO is involved in the selection process of independent directors, this will significantly impair the supposed reaction to stock price returns. Shivdasani and Yermack (1999) claim this is likely when the CEO's choice of independent directors includes those with insufficient time 'busy' directors, according to Core et al., (1999) to engage in significant managerial monitoring. This fact further emphasises that the type of outside directors has an effect on their job performance.

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In examining board effectiveness and its effect on a firm's governance, the frequency of board meetings has been used to measure board involvement in monitoring, service and strategic duties in a firm (Lipton and Lorsch, 1992). For instance, firms are found to hold a greater number of board meetings when facing a crisis (Jensen, 1993). In another study, Vafeas (1999) compared the performance of firms that held board meetings regularly and that of firms with an inactive board. His findings indicated that an increase in the amount of board-interaction time, that is, board meetings, had a positive impact on a firm's operating performance.

As well as ensuring balanced and objective views in the board's decision-making process, the presence of a majority of independent directors on the board also provides stronger and more affirmative independent views and judgement at all board deliberations. Moreover, their significant number will give sufficient weight to the value of their opinions and views of the board's decisions (Combined Code, 1998). Essentially, given their main role in protecting and acting in the best interests of shareholders and stakeholders, including acting against entrenchment by managers' or misappropriation by controlling owners, the number of independent directors is crucial in influencing the extent of the board's considerations and the fair representation of shareholders' and other stakeholders' interests in the board's plans and resolutions.

According to Zajac and Westphal (1994), when the board is structured with more members with the particular objective of monitoring top management activities vigilantly, the firm will benefit more from the superior internal control in comparison to firms with a lower level of monitoring. In addition, Daily and Dalton (1993: 70), noted from a former SEC Chairman's comment that

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subordinates of CEOs are unlikely to oppose independent directors' opinions when there is a high presence of them on the board of the firm.

Although the presence of a high number of outside directors is imperative to ensure strong support for independent directors' views among board members, the inputs from executive directors on the board are also essential. For instance, from a strategic management point of view, their board membership helps the CEO in conveying relevant information to outside directors during board meetings and assists forums in evaluating the performance of junior executives with a view to their potential for becoming members of the senior management team (Mace, 1971; Loudon, 1982; Baysinger and Butler, 1985). With extensive inside experience and knowledge of the firm's internal management and operations, executive directors' contributions are particularly valuable to the firm in strategic planning and budget process and crisis management, since they can provide strong backing for an inexperienced CEO (Ford, 1988). The Best Practices Task Force (2004) further acknowledges the valuable input of top management involvement in assisting a firm's board's evaluation of the practicality and suitability of corporate information disclosure policies and procedures.

Nevertheless, these executives are also more likely to favour practices designed to entrench management profit-making at the expense of shareholders' returns, such as payments of greenmail and severance agreements (Singh and Harianto, 1989; Manry and Nathan, 1999). Tosi et al., (2003) found some companies with a majority of outside directors on their board were ineffective in controlling and monitoring their top executives' private rent-seeking behaviours. This situation is more pervasive when firm ownership is widely dispersed and a large

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shareholders' presence is lacking. Further, improvements in the board's control structure may not completely overcome the problems associated with having a certain composition of non-executive directors on the board (Hart, 1995).

Nonetheless, the active involvement and commitment of outside independent directors in ensuring fair representation of shareholders' interests will contribute to establishing and enforcing appropriate firm governance conduct (OECD, 2004). The impartiality of outside independent directors and their relevant knowledge and skills are important factors in justifying their presence on the firm's board (Fama and Jensen, 1983; Wan and Ong, 2005).

4.3.2 *Senior Independent Director*

According to the Hampel Committee (1998), the Malaysian Code of Corporate Governance (2001) and the Higgs Report (2003), it is important for the company to identify a senior independent director of the board, even though the company has different individuals as the Board's Chairman and as the Chief Executive Officer. Notably, in a situation where there is a potential close alliance between the Board's Chairman and the Chief Executive Officer, the senior independent director can act as the independent person to whom other directors and shareholders may convey their concerns.

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Further, the role of a senior independent director is imperative in the relationship between major shareholders, for instance:

- (i) to develop a balanced understanding of the issues and concerns of shareholders
- (ii) where there are unresolved issues between shareholders and the Board's Chairman and Chief Executive
- (iii) to ensure a balanced view is taken of shareholders' views

(Source: Higgs Report 2003 - Paragraphs 7.1-7.5, 15.15 and 15.16)

4.3.3 *Independent Directors' Qualifications*

Libby and Luft (1993) comment that education, training and experience can facilitate the means of accumulating task-related knowledge. Further, DeZoort and Salterio (2001) observe that the amount of experience that company directors have as independent directors and concurrently as directors of a company and members of senior management will affect the way board members exercise their independent judgement, such as in an auditor-management dispute case. On the other hand, directors with subspecialty knowledge, that is, knowledge acquired from past experience of working or dealing with firms in a business or industry related to that of the client, will enhance a person's decision-making skills due to the distinct usefulness and applicability of such resources to the firm's operations (Waller and Felix Jr., 1984).

4.3.4 *Independent Chairman of the Board*

Given the CEO's position as the highest rank of command at management level, there is a high possibility of other executives cooperating with the CEO to set up high compensation for themselves (Yermack, 1997; Monks, 2001) and supporting the CEO's non-strategic propositions

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for firm diversification²¹ (Amihud and Lev, 1981). The continuing focus on the role of the board's Chairman and his/her independence from management influence has centred on his/her position as leader of the board that allows him/her to exert a certain degree of authority, including the authority to influence directly the organisational process (Eisenhardt and Schoonhoven, 1990) and initiate changes and actions in the firm (Daily and Dalton, 1993). Furthermore, the Chairman has a crucial role to play in ensuring impartiality in the expression of constructive views and the credibility of board conduct, and in setting relevant, sufficient and appropriate agendas for board meetings (Dayton, 1984). Consequently, separation of the board's chairman and the firm's CEO is critical to controlling and balancing the latter's domination of the board of directors.

Fama and Jensen [1983(a): 314] posit that a firm will suffer in the competition for survival when the role of Board Chairman and CEO is combined as this allows domination of decision management and decision control by one person. They also indicate that this arrangement is likely to take place when top managers have a strong influence on the firm's decision-control system. For this reason, they argue, it is imperative to separate top-level decision management and decision control to facilitate and motivate further the effective participation by outside directors in their oversight duties of management actions and hence provide better representation of shareholders' interest.

As has been emphasised, the presence of a significant number of independent directors on the firm's board of directors is required to ensure the objective representation of shareholders'

²¹ Namely for the purpose of empire building and to extend the CEO's personal prestige and status.

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interests (Useem, 1998). As the leader of the Board, the independent Chairman can monitor, control and discipline management activities strategically on behalf of shareholders (Kose and Senbet, 1998). In terms of impartial and objective support, the appointment of an independent Chairman provides an environment conducive to encouraging participation from other independent outside directors, particularly in critically evaluating management agendas and openly conveying their concerns regarding assessments (Gregory, 2001).

At board level, the separation of the roles of Chairman and CEO is essential to ensure fair and objective procedures are enforced in the decision-making process without it being pressured, controlled and dominated by the CEO's personal demands (Begley and Boyd, 1987). Dayton (1984) contends that the appointment of the CEO as Board Chairman will affect the board's agendas, freedom of viewpoint, deliberations of objective discussions and the nomination of board members. Anderson and Anthony (1986) add that, the separation of the roles of Chairman and of CEO will ensure better management of the organisation and a healthy relationship amongst board members.

However, Donaldson and Davis (1991) argue that combining the duties of the Board's Chairman and the duties of the CEO provides greater clarification and consistency in terms of the firm's policies, leadership and control. Nevertheless, in order for the firm to benefit fully from this arrangement, the Chairman-CEO needs to project and implement actions that are in keeping with the firm's value creation motives and to embrace the full spirit of stewardship and accountability for the firm's long-term prosperity (Clarke, 2004).

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4.4 Non-Executive Directors and Affiliated Directors

Cheah (2003:2) describes a non-executive director as a company director who is not a full-time director but attends board meetings to facilitate board decisions with his/her acquired skills, knowledge and experience. The independence of this director from management is impeded by his/her business and management association with the firm and by any family relationship with management.

Vicknair et al., (1993) describe 'grey directors'²² as directors who are not employees of the board of the company they are serving but potentially have an association with the company or its management. Their relationship may ensue from a family link with members of the management, the provision of a consultation service and advice, or from previous employment with the firm (Beasley, 1996). Emphasis on the importance of the independence and externality of independent directors ensures the views, advice and judgement provided by these directors are not impaired or compromised by their bias towards management preferences. For instance, Byrd and Hickman (1992) found that outside affiliated directors' involvement in monitoring bidding offers is not as significant and effective as when independent directors dominate the board. Further, monetary incentives are one of the factors that motivate the collaboration between grey directors and management (Vicknair et al., 1993).

Importantly, the number of grey directors on the board may prevent the fair representation of interests when their numbers represent a majority vote. In particular, small shareholders'

²² The term used by Beasley (1996: 448) for directors with non-board affiliation.



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interests will not be appropriately considered if board members' independence is compromised by their underlying connection with and manipulation by management (Herman, 1981; Wolfson, 1984).

4.5 Board Subcommittees

As discussed in section 4.2.3, the board subcommittee is one of the important elements of board of director structure (Zahra and Pearce II, 1989). Subcommittees' impact on board roles' performance can be examined in terms of the type of subcommittee, composition of subcommittee membership and the dissemination of information in the committee (Zahra and Pearce II, 1989:307).

Further, the impact of board subcommittees on financial performance can be investigated directly or indirectly (Zahra and Pearce II, 1989:308). In particular, the examination of the subcommittees' attributes (i.e. composition, structure, process, characteristics) directly on firm performance indicate the direct impact of board subcommittees on firm performance. On the other hand, the indirect impact of board subcommittees on firm performance indicates how firm performance is affected by the impact of subcommittees' attributes on board of directors' roles performance (Zahra and Pearce, 1989).

Primarily, the establishment of board subcommittees such as audit, nomination and remuneration committee is important to facilitate the management and deliberation of board of directors' critical duties [Conyon and Peck, 1998; Klein (1999, 2000); Vafeas, 1999(a)]. Namely, the assignment of the board's financial oversight duties to the audit committee

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establishes a formal procedure for effective evaluation of the firm's financial position, reporting practice and internal control procedures (BRC, 1999). In addition, the selection process and nomination of board's and top management candidatures are also part of the board of directors' primary duties (Fama and Jensen, 1983; Dalton et al., 1998).

The formation of a nomination committee will lead to implementation of formal and transparent procedures for the selection of board members and hence the determination of board composition as well as board of directors' performance on an ongoing basis (MCCG, 2001; Higgs Report, 2003). The Cadbury Report (1992) also emphasised the importance of establishing a remuneration committee in the firm. Given the tendency for executive officers to reward themselves with high compensation without regard of the level of firm performance (see Yermack, 1997), it is critical to form an independent remuneration committee (Conyon and Peck, 1998) which implements the practice of formal procedures in the evaluation of executives performance and compensation policies and scheme (MCCG, 2001; Higgs, 2003; Combined Code, 2006).

The following subsections will examine audit committee, nomination committee and remuneration committee composition and structure and their implications for the fulfilment of their oversight duties. In addition, the financial background of the audit committee will be discussed to assimilate its importance and relevance to audit committee financial oversight duties.

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4.5.1 *Audit Committee*

The importance of the audit committee as a subset of the corporate board becomes prominent with the delegation of specific responsibilities to oversee and govern the credibility of a firm's financial position and reporting and auditing process [Public Oversight Board (POB), 1993; Turpin and DeZoort, 1998; Blue Ribbon Committee (BRC), 1999; MCCG, 2001; McDaniel et al., 2002). Currently, growing public pressure for greater accountability has been brought on by major corporate collapses, further emphasising the need for its establishment by listed issuers (Baxter and Pragasam, 1999). A board will delegate the responsibilities for financial reporting process evaluation to an audit committee (Beasley, 1996). Moreover, an audit committee is needed to act as an independent and objective governing body in the firm, which is vital to improve the firm's corporate governance (DeZoort and Salterio, 2001) and to facilitate effective enforcement of the audit committee's oversight function, which again is critical to mitigate the risk of corporate failures and the lessening of public confidence (Hackenbrack and Nelson, 1996; Lee and Stone, 1997; DeZoort, 1998).

The audit committee's internal control oversight duties have been frequently cited by many researchers, for example, Abdolmohammadi and Levy (1992); Wolnizer (1995); DeZoort (1998); Tan and Kao (1999); MCCG (2001); and Millichamp (2002), all of whom have emphasised the importance and implications of the performance of such a role for the credibility and reliability of the firm's systems of control and investors' investment decisions. The audit committee's experience and comprehension of the internal control evaluation process is necessary to support and encourage auditors' assessment of the state of the firm's control system

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such that their audit plan and procedures are structured to identify and uncover errors and fraudulent practice (DeZoort, 1998; Caplan, 1999).

Due to its primary duties in overseeing the firm's financial processes, the formation of the audit committee has been linked with the strengthening of a firm's financial control (see, for example, Collier 1993; English 1994; Vinten and Lee 1993). In particular, studies by Defond and Jiambalvo (1991) and Dechow et al., (1996) have examined the role of the audit committee in curbing the misrepresentation of financial statement items. Further, according to Diamond and Verrecchia (1991), when value-maximising managers use corporate disclosure as a mean of reducing information asymmetry this improves the future liquidity of the company in the form of lower capital- cost.

A recent study by Gendron et al., (2004) on audit committee meetings, found key aspects of the committee's work included asking challenging questions and evaluating the reports and feedback of managers and the audit findings of auditors. Such findings signify the importance of audit committee members' self-awareness and initiative, that is, the need for them to be proactively involved and committed to the tasks and matters pertaining to their duties. On a large scale, these actions will generate a subsequent improvement in corporate governance, better protection of shareholders' interests, and mitigation of the misappropriation of assets and misrepresentation of information (Kirk, 2000; Turley and Zaman, 2004). The credibility of a firm's corporate governance is important to ensure and increase investors' confidence and has further implications for reducing the cost of doing business (Kala, 2001)

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Additionally, the effectiveness of the audit committee depends on its collective ability to meet its oversight objectives (DeZoort, 1998). The rules and regulations pertaining to its authority and functions are strengthened by regulatory bodies' support and this, in turn, signifies its importance as an oversight body in the firm and hence facilitates the ease with which it can fulfil its prescribed duties with the co-operation of employees and management in the firm (Carcello et al., 2002; Haron et al., 2005). The moves by the Stock Exchange to incorporate audit committee rules in its corporate governance listing requirements are perceived to be effective in enforcing the good functioning of the board and board committees (see, for example, Shleifer and Vishny, 1997; Abdulrahman et al., 2002; La Porta et al., 2002; Orbay and Yurtoglu, 2006).

In terms of the committee's position at board level, it functions as a committee of the board (FRC, 2003). This means that when there is disagreement between the committee and other board members, the issues will ultimately be decided in boardroom meetings.

4.5.1.1 Audit Committee Functions

According to MBSB's Revamped Listing Requirements (2001: Para 15.13), an audit committee's duties are:

- i) to review the audit plan with the external auditor and subsequently make a report to the board of directors of the listed issuer,
- ii) to review the system of internal control with the external auditor and subsequently make a report to the board of directors of the listed issuer,
- iii) to review the audit report with the external auditor and subsequently make a report to the board of directors of the listed issuer,

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- iv) to review the assistance given by employees to the external auditor and subsequently make a report to the board of directors of the listed issuer,
- v) to review the adequacy of the scope, functions and resources of the internal audit department to ensure that it has the necessary authority to carry out its work, and subsequently make a report to the board of directors of listed issuers,
- vi) to review the internal audit programme, and its outcomes,
- vii) to review the quarterly results and year-end financial statements, prior to approval by the board of directors, focusing particularly on:
 - a) changes in or the implementation of major accounting policy changes
 - b) significant and unusual events, and
 - c) compliance with accounting standards and other legal requirements,
- viii) to review any related party transaction and conflict of interest situation that may arise within the listed issuer or group, including any transaction, procedure or course of conduct that raises questions concerning management integrity,
- x) to view any letter of resignation from the external auditors of the listed issuer,
- xi) to ascertain whether there is reason (supported by grounds) to believe that the listed issuer's external auditor is not suitable for re-appointment, and
- xii) to recommend the nomination of a person or persons as external auditors.

According to FRC (2003), audit committee members' roles are specifically to act independently from executives and ensure the financial reporting practice and internal control of the listed issuer are reliable and credible to protect the interests of shareholders. Importantly, the size, complexity of the business and risk profile of the company will further determine the extent of the audit committee's oversight responsibilities and working schedules (FRC, 2003).

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4.5.1.1.1 Authority

It is important for audit committee members to recognise and understand what their job description requires them to accomplish, because this will affect their commitment to performing their responsibilities. In addition, the rights and authorities attached to their job designation, particularly their access to the firm's resources, documents and personnel, employees' cooperation and the company's provision for them to seek external experts' advice, will affect their efficiency and the quality of their job performance, when taking into account the time and costs they spend completing specific tasks.

The Kuala Lumpur Revamped Listing Requirements (2001: Para 15.18) establishes the authority of the audit committee as being to:

- i) investigate any matter within its terms of reference,
- ii) access the resources required to perform its duties,
- iii) obtain full and unrestricted access to any information pertaining to the listed issuer,
- iv) have direct communication channels with external auditors and person(s) carrying out the internal audit function or activity,
- v) obtain independent professional or other advice when needed, and
- vi) convene meetings with external auditors without the presence of executive members of the committee whenever this is deemed necessary

The authority cited above signifies the Stock Exchange's recognition of the importance of pre-determined audit committee rights, primarily to assist committee members in dealing with potential resistance from management regarding access to specific company information and seeking outside professionals' advice. In other words, implicit in these rights is the need for

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management to acknowledge and comply with the stipulations. Such rights can provide useful criteria for the evaluation of directors' effectiveness.

4.5.1.1.2 Audit Committee's Report

Notably, the Kuala Lumpur Stock Exchange Revamped Listing Requirements (2001: Para 15.16) requires public listed companies to include the following subjects in their audit committee report:

- i) the composition of the audit committee including the names of audit committee, members and the chairman of the committee, and the independence of audit committee members from management association,
- ii) the terms of reference of the audit committee [this provision prescribes the authority and duties of the audit committee - see MBSB's Revamped Listing Requirements (2001: Para 15.12)
- iii) the number of audit committee meetings held during the financial year and details of the attendance of each audit committee member,
- iv) a summary of the activities of the audit committee in the discharge of its functions and duties for the financial year of the listed issuer, and
- v) the existence of an internal audit function or activity and, where there is such a function or activity, a summary of the activities of the function or activity. Where such a function or activity does not exist, the listed issuer needs to provide an explanation and clarification of the mechanisms that exist to enable the audit committee to discharge its functions effectively.

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The Sarbanes-Oxley Act (2002) extended the duties of audit committees to include selecting, compensating and overseeing external auditors, and resolving disputes between management and external auditors. These duties have also been adopted in the Malaysian Bourse Securities Limited (MBSB) Listing Requirements, 2001, and the US Stock Exchange Commission Listing Requirements, 2003. According to Abbott et al., (2003), the audit committee contributes to better quality audit work by advising management to appoint knowledgeable and reputable auditors. Kirk and Douglas (1996) claim it is important for external auditors to understand the practices of particular industries, and the corporate culture and motives of their client companies since their personal judgement is needed to assess the quality of the client's financial reporting to reflect the unique and differing accounting and disclosure choices in accordance with the company's circumstances. By stipulating audit committee members' duties in the audit committee report, the public are being informed of their obligations and responsibilities (FRC, 2003).

Further, the audit committee's direct communication with external auditors, notably to discuss the scope and coverage of audit plans and actions (DeZoort, 1997), indicates the influence that the committee has on obtaining greater efforts and quality from auditors. Also, meetings held between the committee and external and internal auditors allow both parties to have an informed dialogue (POB, 1993; Kirk and Siegel, 1996; McMullen and Raghunandan, 1999), and enable the latter parties to raise issues concerning problems encountered whilst performing their audit duties, for instance, in obtaining cooperation from company employees, accessing relevant documents, and dealing with pressures to perform the audit engagement quickly with or without

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adequate evidence and without the threat of dismissal by management (Knapp, 1985; Carcello and Neal, 2000 and 2003).

Further, both independent committee members and external auditors will benefit from convening meetings that only they attend (Kirk, 2000). At such meetings, audit committee members can freely address questions to external auditors and discuss problems pertaining to the financial reporting process as well as the state of the internal control of the company without feeling concerned that such matters may be too sensitive to raise with key top officers. In response, external auditors can comfortably give their professional opinions and indicate areas they believe need improvement and clarification without feeling any restraint.

If auditors face the problem of doing their job properly but at the same time not upsetting their clients in the process, the need to compromise certain aspects of the auditing procedures to retain the auditor-client relationship may affect auditors' independent conduct. If this is allowed, it will affect the reliability, credibility and quality of information made available to the public in general and shareholders in particular. Kirk (2000) asserts that by bringing together independent directors and independent auditors, their corroboration in corporate governance could improve corporate accountability, enhance independent auditors' professionalism, and contribute a valuable service to the audit function.

In addition, the number of meetings held by the audit committee denotes the commitment and diligence of committee members in investing a substantial amount of time in their

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responsibilities (Kirk and Siegel, 1996). Moreover, McMullen and Raghunandan (1996) found that, regular audit meetings ensure the financial reporting process functions properly, enables the committee to keep abreast of accounting and control-related matters, and signifies the committee's commitment to remaining informed and vigilant. Based on the 1994 study findings, Coopers and Lybrand (1994) suggested that an effective audit committee should meet between at least three to four times a year.

The BRC (1999), also states that the audit committee should conduct at least four meetings per financial year to ensure an adequate, appropriate and up-to-date assessment of a firm's quarterly performance. By meeting regularly, the audit committee will remain abreast of accounting and auditing matters (Raghunandan et al., 1998). Significantly, material accounting and auditing issues raised during meetings with internal and external auditors can be appropriately addressed by directing internal and external auditors' efforts and resources accordingly to resolve the matter in a timely manner. Resolving problems at an early stage reduce year-end audit time pressures that otherwise can potentially impair external audit quality (Public Oversight Board, 2000). Further, restatement of the financial report can be avoided by detecting and correcting misstatements prior to the issuance of the financial statement (Abbott et al., 2004).

Another vital role of the audit committee is to preserve and protect auditors' independence (Klein, 2002). This is crucial to ensure the credibility of a firm's financial reporting practice, to provide fair representation and appropriate protection of shareholders' interests, and to protect auditors from unnecessary pressures that may affect their work performance and expose them to unethical conduct inherent in their profession (Kirk and Siegel, 1996). To achieve this, the

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Sarbanes Oxley Act (2002) extended audit committees' responsibilities to evaluating the performance of external auditors in order to reduce management influence on auditors and thus strengthen auditors' positions.

4.5.1.2 Composition and Structure

The establishment of an independent audit committee signifies a firm's commitment to implement good corporate governance practice (Sommer, 1991), although the effectiveness and efficiency of the committee are potentially affected by the ease with which committee members can express their impartial views and judgements and undertake justifiable actions (Carcello and Neal, 2000). Bédard et al., (2004) argue that a greater number of independent directors in an audit committee will facilitate the objective assessment of corporate financial reporting practice, as they will have stronger support when speaking against management propositions when the need arises. Particularly, Cohen and Hanno (2000) add that the committee's independence and reliability are crucial in assisting auditors' evaluation of their client's business viability and decisions regarding the control risk for specific audit assertions, including the extent of substantive testing to be performed.

Hence, to protect shareholders' interests and to provide an environment conducive to auditors fulfilling their statutory duties, the committee needs to oversee management activities objectively (Lee et al., 2004) by being impartial when dealing with matters concerning the management and direction of a company [MBSB, (2001, 2006)]. In other words, an independent audit committee member is expected to ensure that the board of directors has been fulfilling its oversight roles, and management, in particular the financial director (Willians, 2007:14), are

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held accountable for actions taken that are against shareholders' interests (Haron et al., 2005). Equally important is managers' affirmation of their duty of loyalty to shareholders, as this will determine their ultimate actions and as such have further consequences for investors' investment decisions in the firm (OECD, 1999).

Lee et al., (2004: 136) identify independent directors as those who are not:

- i) an employee or former employee/officer of the firm or of a related entity;
- ii) a grey director, which includes:
 - a. a relative of an executive;
 - b. a person with a business relationship with the firm;
 - c. a large customer or supplier to the company, except for transactions taking place at arm's length or during the normal course of business; and
 - d. a director of related companies

The highly regarded Blue Ribbon Committee (1999) recommends firms form an audit committee comprised solely of independent directors. The presence of insiders, that is, those with an executive position in the firm will prevent the effective monitoring of information prepared by the management. Independent directors will be more productive, fair and transparent in performing their monitoring role on behalf of shareholders since they are free from any business connection as well as separate from the operation and management of the company. They will be valuable informers to the shareholders as their interests focus on ensuring a supply of reliable, sufficient and trustworthy information to them from management, and internal and external auditors.

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Further, the audit committee can assist in establishing an effective internal control system in the company through the monitoring of internal and external audit functions (Beasley and Salterio, 2001). More specifically, the control strength of the firm acts as an indicator of the uncertainty level of the occurrence and extent of errors in management practice (Caplan, 1999). Significantly, its reliability assists the compilation of audit evidence, which is more informative in relation to potential fraud.

Given the increase in financial scandals, the BRC (1999) proposition was later made mandatory in the Sarbanes Oxley Act (2002). Moreover, studies by Dechow et al. (1996) and Klein (2002) indicate that the presence of a greater number of independent directors in an audit committee reduces the likelihood of financial fraud. The appointment of outside directors to the board has a particular purpose, that is, to represent shareholders' interests in the firm and hence be responsible for governing their interests (Fama, 1980; McMullen and Raghunandan, 1996). For directors to be effective on an audit committee, they need to embrace a probing attitude when assessing and discussing management decisions (Gendron et al., 2004). This attitude becomes particularly apparent when the audit committee is comprised solely of independent directors (McMullen and Raghunandan, 1996).

Financial reporting problems can also be averted, given independent directors' dominant influence in ensuring objective, fair and firm decisions to achieve a quality assessment of financial, reporting and audit practice (Abbott et al., 2004). Career wise, the independent directors of the audit committee are potentially exposed to the ruin of their reputations and to legal penalties when their companies experience failures in financial reporting (Srinivasan,

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2004). Hence, since external auditors are involved primarily in the firm's statutory audit task, their independence needs to be protected and assured along with the integrity and objectivity of their judgements to avoid any misrepresentation of information. Otherwise, the preferences of the client's management may prevail over auditors' evaluation (POB, 1993; Kirk and Siegel, 1996). To achieve such protection and assurance, it is important that the relationship between the board of directors and the independent auditor be strengthened. This is because an audit committee and a board of directors that are well informed will be better acknowledge the significance of quality financial reporting and hence be more committed to fulfilling their corporate governance responsibilities (Kirk and Siegel, 1996).

At the same time, the chairman of the audit committee should be elected from amongst the independent directors. Notably, the chairman plays a vital role in ensuring the committee's meetings are conducted in a fair and cooperative environment, such that each member and all other parties, namely, the external auditor, internal auditor and key corporate officers who are invited to the meeting, do not feel inhibited from expressing their real concerns (see Raghunandan et al., 1998; BRC, 1999). Additionally, Kirk and Siegel (1996) suggest for best practice it is beneficial for auditors to meet the audit committee's chairman in advance to discuss and explain any issues in a less-pressured environment. This will allow the auditors to clarify their motivation and objectives and give the chairman the opportunity to discuss with them issues of concern, which will help the auditors prepare appropriate materials for the forthcoming meeting.

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Moreover, the practice of establishing separate sessions for the meeting between independent audit committee members and external and internal auditors without the presence of executive directors or officers will provide an open, useful and dynamic forum (Williams, 2007:14), especially on issues that may be sensitive to the executives.

4.5.1.3 Financial Knowledge

Several researchers have linked the contributions of director(s) possessing financial knowledge to audit committee effectiveness, particularly, their potential in providing a good quality audit and financial assessment of the firm and in reporting and rules compliance (Treadway Commission, 1987; DeZoort et al., 2001; Felo et al., 2003; Defond et al., 2005). As has been noted, the inadequacy and failure of audit committee members to understand their responsibilities are due to their lack of knowledge and experience in accounting and auditing areas (POB, 1993). These weaknesses have been related to the technical aspects inherent in some of the audit committee's oversight duties, primarily, those duties concerning internal control evaluations (Abdolmohammadi and Levy, 1992; DeZoort, 1998; Tan and Kao, 1999; Malaysia Task Force on Internal Control, 2000; Gendron et al., 2004; Haron et al., 2005).

Further, Knapp (1987) observed, disputes between auditors and management to be frequently associated with the accounting estimation adopted by the latter. In addition, the divergence of oversight decisions made by committee members with and without auditing and internal control experience will cast doubts on their ability to govern corporate activity and to facilitate corporate accountability, especially against potential fraud and internal control weaknesses (DeZoort, 1998). It is argued that audit committee members with accounting and auditing

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experience will provide important support and justification for auditors' views and increase auditors' productivity from members' inputs of relevant comments (Boner and Lewis, 1990).

The efficacy and ease of communication between the audit committee and auditors are vital, because auditors can be an important source of information and assistance for the committee to oversee shareholders' interests (DeZoort, 1998). In addition, the two-way communication between these parties will improve the firm's corporate governance. Better clarification of the problems will assist the committee's subsequent informed judgement (DeZoort and Salterio, 2001). Thus, according to the Cohen Commission Report (see Kirk, 2000), discussions and decisions made without the input of competent members may impair the audit committee's judgement.

Further, Libby and Luft (1993) comment that, discrete measures need to be focused on the impact of accounting-related decision-making tasks and also those decision-makers who are involved in accomplishing this task. Primarily, this consideration will assist in improving understanding of the factors that influence performance in an accountancy setting. To consider one particular aspect, accounting-related tasks can exist with multiple degrees of complexity, which require a certain level of ability, knowledge and effort for their successful execution (Kalbers and Fogarty, 1993).

With regard to other aspects of accountancy, discrepancy in decision-makers' abilities, knowledge, motivation and productivity have implications for job performance (DeZoort, 1998; Gay, 2002; Clarke 2004). Considering all these, the co-activation of both aspects, notably, assigning the relevant experts to perform tasks related to their wealth of knowledge, will ensure

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greater compatibility in their work engagement and hence an effective completion of their duties (Einhorn, 1974). It has also been recognised that experts possess a greater ability to retrieve related information and organise more comprehensive sets of relations among pieces of information than novices (Bonner and Lewis, 1990).

Moreover, their experience provides a greater range of information and larger concepts for the solving of accountancy problems, rather than confining the problem solving to the literal and data driven approach used by novices (Moeckel, 1990). According to Tan and Kao (1999), personal commitment to the accountability of an assigned task is influenced by the individual's possession of the requisite knowledge and abilities. Given the task complexity, a person's knowledge and problem-solving ability are adapted to meet his/her accountability. Also, from the point of view of CPA firms, the accountability condition is necessary to persuade auditors to perform accordingly. In a further comment, Tan Kao (1999) claims that as accountability have an impact on the individual's performance, the attributes of the person performing the tasks need to be compatible.

Ryan et al., (1992) found accounting practitioners have influence over the accounting practices of the company and due to their professional ethics will work in the best interests of shareholders and creditors.. Accordingly, McMullen and Raghunandan (1996) emphasise the significance of accounting, internal controls and auditing expertise in an audit committee and identify them as the key to audit committee effectiveness. One reason is that the congruity and synchronicity of opinions between the audit committee and auditors are important to achieve sound judgement. For instance, as DeZoort (1998) observes, an audit committee with previous

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internal control experience provides greater credibility and fewer clashes of opinion with the auditor.

BRC (1999) identifies financial experts as those who have employment experience in accounting and finance, and/or CPA qualifications and equivalent experience, and include CEOs and senior executives with financial oversight responsibilities. Lee et al., (2004) regard financial experts as including those with CPA qualifications, investment bankers, venture capitalists, CEOs, CFOs, Vice–Presidents of Finance, controllers or treasurers. Provision of the Sarbanes Oxley Act requires public companies to disclose to the Securities and Exchange Commission (SEC) the presence of a financial expert on the audit committee. In the case of Malaysia, the Malaysian Bourse Securities Limited (MBSB) Listing Requirements 2001 obligates public companies to include in their audit committee at least one member who is either a financial expert, such as a member of the Malaysian Institute of Accountants (MIA), or with a related professional background, or who is financially literate, such as those possessing an undergraduate or postgraduate qualification in accounting and finance.

DeZoort et al., (2001) found audit committee members with corporate governance experience and financial reporting and audit knowledge provided reliable and credible support to auditors in dispute with the client's management and could justify their substance over form concerns. Working in the same area of research, McDaniel et al., (2002) examined how these two groups with differing accounting experiences make judgements about the quality of the financial reporting, including their perceptions of the frameworks for evaluating reporting quality, the assessment of three characteristics of quality financial reporting (namely, relevance, reliability

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and comparability), the identification and reporting of concerns/issues, and the evaluation of the quality of the reporting of financial statement items. They revealed substantial differences in the response and approach of the financially literate, namely, executive MBA graduates, and financial experts, that is, audit managers when discussing and evaluating the quality of financial reporting. Notably, their level of technical accounting knowledge and their skills influence their answers.

McDaniel et al., (2002) further posits that the inclusion of a financial expert group in an audit committee will provide the appropriate structure for the discussion of overall reporting quality as well as improve the organisation of reporting elements. This is because, compared to the financially literate group, this group is consistent in relating the framework of financial reporting to the characteristics of quality financial reporting. Additionally, in terms of the groups' priorities regarding reporting issues and reporting treatments of financial items to discuss with the auditors, financial experts emphasise recurring activities, whilst the financially literate are likely to focus on issues that receive greater press coverage.

In terms of setback, McDaniel et al., (2002) further argue that the appointment of financial experts in the audit committee will focus the committee's efforts on issues that are viewed by financially literate directors as having less priority. Apparently, the divergence of audit committee members' areas and levels of financial knowledge and skills have further consequences for their decisions on the treatment of particular financial issues. Bearing this in mind, Carcello et al., (2006) conducted a study on the impact of certain types of financial expert groups, namely, accountants, financial brokers, investment brokers, CEOs, and individuals with

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management experience when performing audit committee financial oversight duties. They argue that the first group is critical when evaluating a firm's compliance with accounting standards and treatments, whilst the second group has a significant impact on reviews of a firm's investment prospect plans. Nonetheless, it is inappropriate to assign someone with CEO and/or general management practice to perform such duties, as they will be lacking in the training of task-specific knowledge.

Moreover, financial experts with auditing and accounting experience have the ability to communicate their views and recognise the quality of financial reporting on a timely basis (Kirk and Siegel, 1996). Such ability includes giving their professional opinion and evaluation of the relevance of the estimates of the firm's financial items, and the appropriateness of the firm's accounting principles and disclosures practice given the firm's specific circumstances. Defond et al., (2005) indicated that a more positive market reaction occurs on the announcement of the appointment of accounting financial experts to the audit committee than the appointment of non-accounting financial experts. Accounting financial experts are associated with the provision of a better quality financial reporting assessment. Also, many firms with relatively strong corporate governance appoint such experts, indicating their commitment to employing appropriate and relevant people for the designated tasks, thus ensuring shareholders' value creation. In contrast, appointing audit committee members from a wide variety of backgrounds creates feelings of inadequacy and ineffectiveness in terms of accounting and auditing experience and technical knowledge (Kalbers and Fogarty, 1993).

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Considering a real case situation, Williams (2007:14) gathered evidence from the trial case of the former Chairman of Hollinger, Lord Black of Crossharbour, who had allegedly conspired to steal the company's money to the value of US\$60m (£30m). His findings indicated that audit committee members cannot perform their financial oversight duties appropriately without the support of a financial expert. One of the company's former audit committee members, economist Marie-Josse Kravis, informed the court that even though the committee had been continuously monitoring the company's financial standing, the committee had failed to operate according to its governing charter, which required the involvement of financial experts in their decision making.

On the other hand, it is not necessarily the case that a firm's compliance with the rules and regulations will guarantee users of the financial report an optimum investment decision and that the board of directors will meet their corporate governance responsibilities (Kirk and Siegel, 1996). One reason is that the auditor may apply value judgements in determining the suitability of a particular generally accepted accounting principle over another, as well as in assessing the quality of the financial reporting. Moreover, the latter does not involve public reporting whereby auditors give their opinions to assist management and directors in making their corporate governance decisions. In addition, the nature of the auditors' job means he/she should have considerable hands-on experience, skills, recognition of and familiarity with the mechanics, motives and justifications for various accounting principles, methods and estimates, and disclosure practices that emphasise his/her competency in the respective area.

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Further, if corporate management is left to decide the firm's accounting disclosures on their own, they may barely comply with the generally accepted rules (Kirk and Siegel, 1996). However, ultimately, management need to decide whether to reassess and make appropriate changes following the suggestions of the auditor. In this instance, the influence of independent directors and support of the auditor's judgement are crucial because they can persuade management to implement the auditor's propositions. Importantly, management failure to resolve issues relating to a breach of any listed ruling that has been highlighted by the audit committee and by the external auditors' assessment may result in the firm being penalised by the Securities Exchange and Commission (MBSB, 2001). Notwithstanding, an audit committee will also benefit from having members from both financial and non-financial backgrounds as such a quorum will enrich the committee's views and inputs, which will be valuable for effective discussions of the issues at hand (Krishnamoorthy et al., 2002).

In addition, to ensure audit committee effectiveness, it is important for committee members to be able to comprehend the firm's internal control process and operations to enable them to detect and prevent financial reporting failures and mitigate potential management fraud (Spira, 1999). Kinney (2000) indicates that such knowledge has an impact on the welfare of directors, management, trading partners, auditors, shareholders and society at large. In particular, such knowledge can assist external auditors in their audit assignment specifically by reducing audit risk and allowing them to fulfil their assurance duties (Beasley, 2000), especially when the committee meets frequently with the internal auditor and is involved on a practical level in building and maintaining a reliable and cooperative relationship between external auditors, management and internal auditors (McMullen and Raghunandan, 1996).

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Bonner and Lewis (1990) debate whether auditors' years of experience are an indicator of similarity of knowledge acquired amongst them. They comment that subspecialty knowledge, which is acquired from working with a specific audit client or certain industries or firms, distinguishes the experience accumulated by practitioners regardless of their level of experience. Einhorn (1974) adds that, the differences in approach selected by experts in managing problems are greatly influenced by their experience and training in particular areas. As Chapman and Chapman (1969) point out, experts cannot be expected to arrive at similar conclusions at all times since their past exposures will have influenced the development of their preconceived ideas, which, in turn, will determine their ways of organising information and hence of making decisions.

Importantly, audit committee members' ability to identify relevant oversight issues and later to respond to them appropriately is critical for the committee's overall effectiveness (DeZoort, 1998). Specifically, this is because members who are able to anticipate and provide more related inputs by highlighting other potential aspects and supplementing additional information to oversight tasks will strategically improve the credibility of the collective decisions made by the committee. Nonetheless, DeZoort (1998) found members without auditing and internal control experience were more critical in their assessments of internal control strength than their experienced counterparts. Due to their lack of experience, they tended to be additionally cautious, conservative and diligent, which made them effective contributors to the overall committee effort. Such findings suggest that audit committee members' lack of specific knowledge and experience related to their technical oversight task performance does not necessarily lead to suboptimal performance.

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4.5.2 *Nomination Committee*

One of the main criticisms of top executives' involvement in the directors' nomination process is their preference for individuals who are not inclined to monitor their activities (Jensen, 1993). Primarily, the nomination committee is important for the fair and objective selection of prospective board members, for the appraisal of current board members' performance, and for the further control of top managers, namely, the CEO, whose influence can dominate the proceedings (Shivdasani and Yermack, 1999). Even though current procedures for the appointment of directors require shareholders' approval and votes for candidates (Bathala and Rao, 1995), the CEO's choice still prevails because the CEO has been identified as the person with the greatest authority (Mace, 1971) and influence (Lorsch and MacIver, 1989; Hambrick and Mason, 1984) over directors' choice of candidates. Also, shareholders' ratification of the board's choice of directors' nominees without argument has allowed this norm to persist (Vafeas, 1999a)

The significance of the nomination committee to a firm's governance is underscored by its crucial role and proactive involvement in the assessment and evaluation of candidates to be selected and appointed as board members [Vafeas, 1999(a)]. In order to reduce management domination and influence on the nomination and election process of directors, the nomination committee needs to be managed and led by independent directors (Vicknair et al., 1993). Their active involvement in the committee's decision-making process will consequently determine the future composition of the audit committee and of the remuneration committee. The establishment of the nomination committee also facilitates the organised and systematic search for knowledgeable and experienced independent outside directors (Gregory, 2001). This is

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because the committee represents the views of people from a team of directors, sitting together to evaluate the performances of prospective and present directors, and is not merely an individual's appraisal (Vafeas, 1999). Moreover, the quality of the committee's decision-making will be enriched given outside directors' broad knowledge and experience (Hill, 1982).

The early code of corporate governance, known as the Cadbury (1992) and later the Combined Code (1998), have consistently insisted on the active involvement and participation of independent non-executive directors in the selection and appointment process of key executives and top level management. Thus, commitment from competent and credible non-executive directors is imperative in overseeing and influencing the board of directors' conduct.

Importantly, Shivdasani and Yermack (1999) indicate that the appointment of fewer outside directors and more grey directors with the subsequent conflict of interest is more apparent in firms without a nomination committee. This is consistent with Andrews' (1987) view of nomination committees, that given the scope of their authorities they are important mediums for increasing the representational proportion of independent directors on the board. It has also been observed (Yermack, 1997) that stock price movement is significantly lower in relation to the announcement of the appointment of independent directors if the CEO is on the nomination committee.

However, the appointment of outside directors to the board does not necessarily indicate companies' awareness of and commitment to the need to embrace good corporate governance. In fact, firms experiencing poor firm performance in previous years have used the

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mentioned governance mechanism to camouflage their dire situation (Bhagat and Black, 2002). Another study has shown how top management's strategic choices for organisational performance are influenced by their outside connections (Geletkanycz and Hambrick, 1997). Thus, executive directors are unlikely to appoint outside directors if they view them as unlikely to add value to the firm.

The presence of executive directors on the nomination committee will also limit outside directors' freedom to appraise top management objectively given that their future re-election to the board is affected by top executives' recommendation (Tejada, 1997). On the other hand, the involvement of internal managers in the selection of outside directors is anticipated when the firm's system of internal control is reliable, as noted by Fama and Jensen [1983(a)]. In particular, internal managers' experience and knowledge of the organisation's internal activities will be valuable in identifying relevant human capital needs for better business operations.

Further, the establishment of the nomination committee is significant to ensure fair and objective selection of prospective board members as well as appraisal of current board members' performance (Lipton, 2006). Top executives' involvement in the board selection process has been criticised due to their preference to appoint individuals who are less inclined to monitor their activities (Jensen, 1993). There is also the issue of the domination of directors' selection by the CEO, to increase his/her control over top managers (Shivdasani and Yermack, 1999). Even though the shareholders' approval is required for board of director appointments (see Lipton, 2006:2), Bathala and Rao (1995) argue that this is just an assumed practice. According to Shivdasani and Yermack (1999), the CEO's choice of board candidates will preside over other

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board members' nominees. This practice has been linked with the higher authority of the CEO (Mace, 1971) and his/her influence in the firm's management (Lorsch and MacIver, 1989; Hambrick and Mason, 1984). Also, the lack of challenge on the part of shareholders leaves the board with the upper hand in the choice of director's nominees [Vafeas, 1999(a)].

Specifically, the significance of the nomination committee to the firm's governance is underscored by its crucial role and proactive involvement in the assessment and evaluation of candidates to be selected and appointed as board members, primarily for future monitoring effectiveness [Vafeas, 1999 (a)]. In order to reduce management inherent domination and influence in directors' nomination and election process, the nomination committee needs to be managed more and led by independent directors (Vicknair et al., 1993). Consistently, the New York Stock Exchange has imposed a ruling of full independent director membership on nomination committees (Lipton, 2006). Importantly, their active involvement in the committee's decision-making process will determine the future composition of audit and remuneration committee members. Also, the establishment of a nomination committee facilitates the organization and systematic search for knowledgeable and experienced independent outside directors (Gregory, 2001). This is because the committee represents the views of people from a team of directors, sitting together to evaluate prospective and present directors' performance and not merely an individual's appraisal (Vafeas, 1999). Moreover, the quality of the decision-making of the committee would be enriched considering outside directors' broad knowledge and experience (Hill, 1982).

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4.5.3 *Remuneration Committee*

The Cadbury Report (1992), Greenbury Report (1995), MCCG (2001) and Higgs Report (2003) indicated the formation of a remuneration committee in the firm is important for the implementation of formal and transparent procedures in the setting of executive remuneration policies and package. One of the main functions of the remuneration committee is to assess the contract of employment of senior executives (Carson, 2002). According to Yermack (1997), the lack of proper monitoring and control of executives' compensation scheme may increase executive officer' alliance with the CEO in setting high compensation for themselves. Also, executives have been found receiving higher compensation which was not matched with higher firm profitability but rather due to rise in price, staff redundancy and pay reduction (Greenbury, 1995). In addition, there is an issue of conflict of interests when the board of director is allowed to determine their own remuneration (Greenbury, 1995)

Due to the conflict of interests of shareholders and management, it is vital that the remuneration committee is comprised solely of independent directors (Yermack, 1997; Vafeas, 2000), to assure the reasonability of executives' compensation levels (Monk, 2001) and where applicable, ensure they are consistent with the firm's achievement of a certain level of performance. The aim is to reaffirm that executives' compensation schemes are justified and have been objectively evaluated, and that shareholders' investments are protected from expropriation by managers' excessive remuneration policies (Gregory, 2001). Importantly, the initiative of the committee's independent directors to obtain external consultant advice on executives' compensation will be counterproductive if experts provide such details with inappropriate language and structure (Monks, 2001).

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In terms of the committee's composition, the Cadbury Report (1992) recommends wholly or majority non-executive director membership including a non-executive chairman. In furtherance, Yermack (1997) and Vafeas (2000) proposed independent directors' sole membership on the committee. This is to ensure executive directors' particularly CEO's, non-participation in the evaluation of their own pay. Moreover, the remuneration appraisal process should be conducted objectively and impartially so that the level of executives pay reflects firm performance, and the outside advice obtained ensure their market rate (Monks, 2001).

According to Greenbury Report (1995), remuneration committee members should be individual who are accountable, competent (i.e. have good knowledge of the company's business) and free from financial involvement with the firm. Moreover, the effectiveness of the remuneration committee will enhance the quality of financial reporting and transparency of management performance (Carson, 2002). On the other hand, external consultant advice on executive compensation will be counter productive when experts provide such details in misused language and structure (Monks, 2001).

4.6 Other Corporate Governance Issues

4.6.1 *Founder and/or Family Business*

The predominant presence of founder and family businesses in the corporate environment of developed and developing countries indicates their active participation in and contributions to the generation of a country's income and economic stability (Bhattacharya and Ravikumar, 2001). In the US it has been reported that almost half of the Fortune 500 companies are family

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businesses (Chami, 1999), whilst in Asian regions, they account for 60% of public listed firms (Claessens et al., 1999).

Increasingly, studies on family businesses have examined the approaches and potential practices of sound and efficient business management, taking into account the factors of inheritance, ownership, compensation, presence of the founder, family kinship, and commitment of family members to the business ventures (Davis, 1983; DeAngelo and DeAngelo, 1985; McConaughy et al., 1998; Sharma and Rao, 2000; Anderson and Reeb, 2003; Chan and Lau, 2003).

Given the conflict of interests created by the separation of ownership and management, Fama and Jensen (1983) concur that family-managed firms should be better at monitoring and controlling firm activities. It is recognised that when managers own a large number of shares in a firm, they are unlikely to take actions that may reduce the value of the firm's shares (Morck and Yeung, 2003). Rather, the ownership of large equity mitigates managers' indulgence in private rent seeking and concentrates their aim for firm value maximisation through efficient deployment of corporate assets (Morck et al., 1988), particularly where there is a positive Tobin's Q in family-controlled firms. However, this motive seems to be less transparent when the shares of the firm are widely dispersed (Berle and Means, 1932).

In the case of public companies, the increase in the number of family members being assigned executive responsibilities is part of the strategy for strengthening the managerial vote of the ownership (DeAngelo and DeAngelo, 1985). Also, the number of family members in the firm is

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important for implementing the firm's preferred financing options, as there will be stronger support for there being less debt financing (Jensen and Meckling, 1976). This is to avoid the consequences of default debt payments that could lead to bankruptcy whereupon family members may have to relinquish their shares to bondholders (Agrawal and Nagarajan, 1990) and lose their business inheritance. On the other hand, dominant family shareholders can exert control over corporate policies by directly managing the firm or by closely monitoring the management team (Benedson and Wolfenzon, 2000). Managers in a family business may also act in the best interests of family members rather than of shareholders as a whole (Johnson et al., 2000). Further, the influence of important business associates²³ may prevail in the firm, which may not necessarily be to the advantage of the firm's minority shareholders (Fama and Jensen, 1983).

In addition, the influence of the founder in a firm's structure and process has been widely discussed (Eisenhardt, 1988). Studies have examined differences in the management approach of independent CEOs and CEO-founders (Levinson, 1971 and Willard et al., 1992). The former have been assessed as having more professional attributes than the latter; this may affect the firm's future success (Daily and Dalton, 1993). Nevertheless, the business acumen of other perceived founders is as legitimate as that of non-founders (Alcorn, 1982), considering the initiative they showed in founding the business and ensuring its viability for an extensive period of time²⁴. Other studies have investigated differences in choices of governance structure between CEO-founder and non-CEO founder firms and found variations in the pursuance of

²³ Fama and Jensen (1983: 306) define important business associates in terms of their goodwill and advice.

²⁴ For instance, the period of management since the inception of the business and fulfilment of the Securities' requirements for public listing.

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objectives, for example, income substitution in opposition to large scale business (Birch, 1987), rapid firm growth as a motivating business challenge (Churchill and Lewis, 1983), and non-CEO-founder firms' goal of empire building and faster growth than the goal of steady growth for CEO-founder firms (Willard et al., 1992).

To discipline and oversee family firms' governance to protect them from being inappropriately managed and influenced by family members, the market authorities, such as the Securities Exchange and Commission, enforce requirements for corporations to increase their transparency and disclosure of information (Rhee, 1997-1998; La Porta et al., 2000), including information on potential family relationships amongst board members and shareholders, shareholdings in firms and related party transactions (Thillainathan, 1999; Kuala Lumpur Stock Exchange, 2001).

4.6.2 *Firm Ownership and Shareholdings*

Berle and Means (1932) claim the distribution of firm share ownership has an impact on firm performance because when the firm is widely owned by a large number of small shareholders, the separation of ownership from the management of the business increases the potential for a conflict of interest between owners and managers (Jensen and Meckling, 1976). Hill and Snell (1989) observed a positive relationship between concentrated ownership and firm productivity. The presence of large shareholders signified their influence and close monitoring of firm activities ensured its operational efficiency, in this case, a diversification strategy and R&D investments. Similarly, Leech and Leahy (1991:1418) reported that structure of firm share

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ownership has implications for firm performance in that small shareholders' voting power and/or incentives may not be sufficiently influential to enforce profit maximisation.

On the other hand, Demsetz and Lehn (1985) found no relationship between firm ownership structure and firm performance when examining the impact of firm ownership structure in relation to firm size, type of industry and regulated or non-regulated business on firm accounting profit rates. In another study, Monsen et al., (1968) observed deterioration in a firm's return on investment, when the ownership of the firm was dispersed. However, when separately owned and managed firms act in line with the profit maximisation goal, firms' long-term performance can be sustained (Williamson, 1970).

Leech and Leahy (1991) examined firm ownership through owner concentration and control type. They measured the first by identifying the stake that the largest holdings represented, that is, whether it fell within 5%, 10% or 20% and more of the shareholding spread whilst for the second they employed Cubbin and Leech's probabilistic-voting model where control is defined as '*securing a simple majority in a shareholder vote*' (Leech and Leahy, 1991:1419).

4.6.2.1 **Directors' Shareholdings**

According to Kosnik and Bettenhausen (1992) and Gay (2002), the financial motives discrepancies between owners and managers can be alleviated with appropriate incentives system namely, compensation policies that rewards managers comparable to owners' returns. Specifically, the board of director primary duties was to oversee and control management activities in safeguarding shareholders interests. The setting of director's remuneration scheme

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which rewarded them in accordance to their governing efforts is pertinent for the establishment of appropriate conduct and practice of the firm's governance (Burton, 2000). Bukart et al., (1997) argued the ownership of firm's shares by management is an important incentive to encourage managers practice of effective control on firm activities. They gathered the control right will enhance the managers efforts in making informed economic decision.

Moreover, the firm's shareholdings structure shows the controlling influence of individual owners in deciding who should be the prospective owners (Demsetz and Villalonga, 2001). Demsetz (1983) examined the linear relationship between ownership structure and accounting measure of profit by making ownership structure an endogenous variable. He found no statistically significant relationship between corresponding variables. On the other hand, the investigation by Morck et al., (1988) of similar issues ignored the endogeneity potential of a corporation's ownership structure. They used Tobin's Q and accounting profit rate as measures of performance. Their estimation of insider ownership influence on Tobin's Q indicated a mixed relationship in that management share ownership between 0% and 5% and greater than 25% showed a positive association with Tobin's Q, but a negative association for management shareholdings of between 5% and 25%.

Elson (1996) argued in order to encourage corporate director to be vigilance in their oversight, their compensation should reflect their past performance as well as potential future benefit from their monitoring duties. In particular the opportunistic behaviour of director can be mitigated when directors' compensations reflect shareholders' returns (Jones and Goldberg, 1982). Given the directors non-financial stake in the firm, it cannot be expected that they would monitor the firm activities as what an owner of the firm would do (Smith, 1776). Bhagat et al., (1999)

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contended, the board members ownership of substantial equity in the firm would align the directors and shareholders' interests, namely with effective oversight of management activities by them. Nevertheless they noted outside directors are less likely to hold shares in the firm than executive director. Mallette and Fowler (1992) argued, equity ownership can serve as an effective monitoring incentive for outside directors when they own a sizeable amount of shares in the firm.

4.7 Conclusion

This chapter's presentation and examination of the roles and attributes of boards of directors has indicated that those boards that are independent from management and are appropriately qualified are an important governing mechanism for ensuring decisions and actions at the top level are carried out fairly, objectively and informatively. Moreover, as a body appointed with primary oversight duties in the firm, a board of directors' actions and performance will have implications for the firm's financial performance as a going concern and for its future direction, mainly due to directors' involvement and participation in making and delivering firm policies, having direct access to the firm's personnel and internal resources, and evaluating management's judgement and actions regarding the allocation of firm resources.

Due to the various control responsibilities of boards of directors, audit committees are formed specifically to monitor and supervise the financial reporting process and auditing of the firm. In order to ensure committees' effectiveness, that is, their capability to perform designated roles

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impartially, appropriately and sufficiently, the independence, financial knowledge and experience of committee members are essential, given the audit committee's specific tasks.

In addition, the formation of nomination and remuneration committees will have an inherent effect on the selection and appointment of board of directors' members and their level of compensation. For example, the former committee is responsible for ensuring that those candidates who are selected and appointed to the board are of high calibre, have high credibility, qualifications and commitment to perform their duties accordingly, and are proactively prepared to challenge management's misguided actions. As for the latter committee, its existence and functioning ensures executives are compensated in accordance with their deliverance of quality performance while at the same time hinders the misappropriation of rewards due to the abuse of power, authority and unethical collaboration amongst top executives.

This chapter thus highlights the importance of research on boards of directors' and boards' subcommittees' corporate governance practices in Malaysia, since it demonstrates the imperativeness of directors' independence and qualifications for firm performance and protection of shareholders' interests. Accordingly, this study's findings will make a useful contribution to the economic and financial environment of Malaysia. The next chapter will present the research hypotheses and models.

Chapter 5

~ Research Hypotheses' and Models' Development ~

5.0 Introduction

In the previous chapter, corporate governance theories, empirical studies on board of directors' and board subcommittees' impact on firm performance, and the Malaysian corporate governance environment and associated issues were examined to provide the underlying framework for the development and discussion of the research hypotheses. The research hypotheses are first developed in relation to the impact of board of director attributes, namely, independence composition, leadership and competency, on firm performance. Subsequently, research hypotheses for board subcommittees' attributes' impact, specifically the influence of their respective independence and structure on firm performance, are proposed. Board subcommittees observed are the audit committee, nomination committee and remuneration committee. As regards to the former, its impact on firm performance is extended to include committee members' competency. Further, three corporate theories, namely, the legalistic view, agency theory and resource dependency theory, underlie the arguments for the proposed hypotheses.

5.1 Board of Director Attributes and Firm Performance

In this section, three board of director attributes namely, independence, leadership and competency, are examined to develop their respective influence on firm performance.

5.1.1 *Board of Directors' Independence and Firm Performance*

Primarily, the formation of a board of directors in a firm is underscored by the need to establish a cost-effective internal governing mechanism (Fama, 1980). Its main function is to oversee the conduct of managers and/or owner-managers in their decisions on the allocation of a firm's assets such that managers' conducts are aligned with the maximisation of shareholders' investments (Hermalin and Weisbach, 2003). Furthermore, the ultimate decisions on the firm's strategic policies and planning are made at the board level, which emphasises the imperativeness of the board's objectivity, impartiality and accountability when performing its duties, specifically in fairly representing shareholders' interests [Fama and Jensen, (1983a); Baysinger and Hoskisson, (1990); Beasley, (1996); Ferris et al., (2003); Boone et al., (2007)]. In addition, the independence of board members will ensure that managers' performances are evaluated appropriately (Baysinger et al., 1985).

The outside independent director's non-association with the firm's management, whether through past employment, business dealings and/or family relationship [see Bhagat and Black, (1999); BRC, (1999); Abbott et al., (2004)], underscores his/her suitability to make objective and impartial evaluation and decision-making on a firm's activities and performance. Moreover, their higher composition on the firm's board will ensure greater influence of independent and unbiased views and judgements in the board's decision-making [see, for example, Kosnik, (1987); Beasley, (1996); McWilliams and Sen, (1997); Long et al., (2000)]. In particular, the high presence of independent directors on the firm's board will ensure governance of a firm's assets against management personal profit seeking activities is conducted objectively (Lipton and Lorsch, 1992).

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To-date, several studies have linked independent directors' ability to enforce independent views and judgement at the board level by examining the impact of independent director composition on the board in terms of its proportion, majority (i.e. at least 50%) and dominance (i.e. 51% or above) on firm performance (see, for example, Barnhart and Rosenstein, 1998; Bhagat and Black, 1999; Millstein and MacAvoy, 1998; Dalton et al., 1999; Carter et al., 2003). Notably, Rosenstein and Wyatt (1990) found a positive relationship between the proportion of independent directors and stock price reaction. Similarly, Byrd and Hickman (1992) found that when the firm's board comprised at least 50% of outside directors there was a positive impact on its abnormal return. However, the influence of independent directors' judgements may be impaired by the presence of affiliated directors on the board due to the latter's association with the firm's management through former employment, business dealings and/or family relationship [see Lee et al., 1992; Dalton et al., 1998; Bhagat and Black, 1999; Klein, 2002(a)].

According to the MCCG (2001)²⁵ and the Higg Report (2003), the presence of a senior independent director on the board (i.e. an independent director with years of experience as an independent director) will enhance and strengthen the support of independent views and judgement, and the efficiency of a new dependent director. Specifically, in the case of East Asian corporations, the presence of controlling owner-managers and/or family member directors on the board of firms emphasises the importance of the role of the independent director as the representative of minority shareholders' interests (see, Claessens et al., 2001; Thillainathan, 1999; MCCG, 2001; Mitton, 2002).

²⁵ MCCG (2001) Part 4: Explanatory Notes [Para 4.31 (VII)] states "*Whether or not the roles of Chairman and Chief Executive are combined, the board should identify a senior independent non-executive director of a board in the annual report to whom concerns may be conveyed*". Para 4.32 further emphasises the significance of a senior independent director as an identified independent figure for other directors to express their concerns, especially when the board's Chairman is autocratic and the CEO is powerful and both of them form an alliance].

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Notably, executive directors' influence on board decisions is strengthened when the roles of Chairman and Chief Executive are combined (Shivdasani and Yermack, 1999; Yermack, 1997) since this allows domination of board decisions and control of management [Fama and Jensen, 1983 (a)]. On the other hand, the presence of an independent board chairman will strengthen independent decision-making at the board level (Dayton, 1984). The presence of family member directors on the board may also contribute to firm performance since the need to sustain business prosperity for their next generation may prevent them from taking action detrimental to the firm's future viability (Ho et al., 2004; Morck and Yeung, 2003). However, shareholders' interests will be endangered when decisions taken by family member directors are made in the best interests of their kin rather than shareholders as a whole (Johnson et al., 2000). Thus, Malette and Fowler (1992) posit that independent director presence on the firm's board serves as an essential monitoring device.

In consideration of the above arguments, the following hypotheses are proposed:

HBIND 1: The proportion of independent directors on the board will have a positive impact on firm performance.

HBIND 2: The domination of board of director's composition by independent directors will have a positive impact on firm performance.

HBIND 3: The domination of board of director's composition by the sum of independent directors and non executive directors will have an impact on firm performance.

HBIND 4: The proportion of independent directors with accounting and finance knowledge will have a positive impact on firm performance.

HBIND 5: The presence of a senior independent outside director will have an impact on firm performance.

HBIND 6: The exclusion of Chief Executive Officer, Chief Financial Officer or Managing Director from board of director's membership will have a positive impact on firm performance.

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HBIND 7: The appointment of an independent director as a board of director's chairman will have a positive impact on firm performance.

HBIND 8: The presence of a founder director on the board will have an impact on firm performance

HBIND 9: The presence of family directors on the board will have an impact on firm performance

HBIND 10: Independent director equity holdings in the firm will have an impact on firm performance.

The research models for HBIND 1, 2 and 3 are developed by also examining each of the 3 models with HBIND 4, 5, 6, 7, 8, 9 and 10. According to Zahra and Pearce (1989), the board of director's attributes, namely, composition, structure, characteristics and process are highly interrelated. Studies have found the effectiveness of independent directors in undertaking their oversight duties is affected by their ease and freedom to express their independent views (Kosnik, 1987), controlling owner influence on corporate policies (Bennedson and Wolfenzon, 2002), and their possession of relevant knowledge and skills, particularly financial skills [Francis et al., (1999); Dionne and Triki, (2005)].

Further, the presence on the board of a senior independent director with many years' experience as an independent director will strengthen independent directors' independence of views and judgement, and assist new independent directors' understanding of their duties (see, Higgs, 2003). Such presence is particularly important since the presence of a top executive officer, such as the CEO, on the board may impose a barrier for independent directions to ask challenging questions, given that their appointment has been made by the CEO (Shivdasani and Yermack, 1999), founder of the firm and family-member director (see Anderson et al., 2004) on the board

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of the firm. Bhagat and Black (2002) indicate that a board of directors entirely composed of independent directors signifies the establishment of a ‘monitoring board’. While Farrer and Ramsay (1998) have argued that non-executive shareholdings in the firm may compromise their independence, Bhagat et al., (1999), on the other hand, found stock ownership by outside directors provided an effective monitoring incentive and had a positive impact on firm performance.

According to Malette and Fowler (1992), outside directors will closely align their interests with shareholders’ interests. Further the board’s chairman has a duty to ensure that the board’s procedures are carried out in an orderly and impartial manner (see, Dayton 1984). However, when the role of chairman and CEO is combined, the CEO may dominate board agendas and hence independence in the board’s views may not be achieved (Daily and Dalton, 1993). Thus, the appointment of an independent board chairman is important to establish unbiased views and judgements of board members (Baysinger and Hoskisson, 1990).

Based on the above, the explanatory variables for the ordinary least square model (OLS) of board independence and firm performance (**OLS 1**) are as follows:

- (i) The proportion of independent directors on the board (NINED),
- (ii) Binary coding of 1 or 0 otherwise when the firm’s board composition is dominated by independent directors (DOINED),
- (iii) Binary coding of 1 or 0 otherwise when the firm’s board composition is dominated by the total of independent and non-executive directors (DONEDI),
- (iv) The proportion of independent directors with accounting and financial knowledge and skill on the board (NINACF),

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- (v) Binary coding of 1 or 0 otherwise when there is a senior independent director on the board (SRINED),
- (vi) Binary coding of 1 or 0 otherwise when the CEO or Managing Director is not a board member (EXCEO),
- (vii) Binary coding of 1 or 0 otherwise when an independent director has chaired the board of directors (CHINED),
- (viii) Binary coding of 1 or 0 otherwise when the founder is a board member (FOUD),
- (ix) The proportion of family members on the board (NFAMDI)
- (x) The percentage of independent directors' shareholdings in the firm (NINSDG)

Hypotheses 1, 4, 5, 6, 7, 8, 9 and 10 will be empirically tested using the following OLS 1(i) model:

$$\begin{aligned}
 \text{Firm Performance}_{it}^{26} = & \alpha + \beta_0 \text{NINED} + \beta_1 \text{NINACF} + \beta_2 \text{SRINED} + \beta_3 \text{EXCEO} + \beta_4 \text{CHINED} \\
 & + \beta_5 \text{NFAMDI} + \beta_6 \text{FOUD} + \beta_7 \text{NINSDG} + \sum_{k=1}^5 \text{Control Variables} + \\
 & \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j
 \end{aligned}$$

The following OLS 1(ii) model empirically investigates research hypotheses 2, 4, 5, 6, 7, 8, 9 and 10.

$$\begin{aligned}
 \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{DOINED} + \beta_1 \text{NINACF} + \beta_2 \text{SRINED} + \beta_3 \text{EXCEO} + \beta_4 \text{CHINED} \\
 & + \beta_5 \text{NFAMDI} + \beta_6 \text{FOUD} + \beta_7 \text{NINSDG} + \sum_{k=1}^5 \text{Control Variables} + \\
 & \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j
 \end{aligned}$$

²⁶ Where t represents the respective period the firm performance was observed (i.e. 2002, 2003 or 2004) and i represents the respective industry of the sampled firms.

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The following OLS 1(iii) model empirically evaluates research hypotheses 3, 4, 5, 6, 7, 8, 9 and 10:

$$\begin{aligned} \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{DONEDI} + \beta_1 \text{NINACF} + \beta_2 \text{SRINED} + \beta_3 \text{EXCEO} + \beta_4 \text{CHINED} \\ & + \beta_5 \text{NFAMDI} + \beta_6 \text{FOUD} + \beta_7 \text{NINS DG} + \sum_{k=1}^5 \text{Control Variables} + \\ & \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j \end{aligned}$$

Specifically, the following control variables are employed in the OLS 1 model:

- (i) Firm size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) The amount of non executive directors' remuneration (NREMU),
- (iv) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV) and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL] and
- (v) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]²⁷.

Control variables included in the OLS 1 model to identify factors other than explanatory variables that may have a potential impact on firm performance and hence ensure the robustness of the research model's outputs [see, Bhagat and Black, (1999); Drobetz et al., (2004); Black et al., (2006)]. In particular, firms may change their corporate governance rather than improvement

²⁷ For the purpose of the regression analysis of the research models, the industrial products industry is identified as benchmark industry (see Field, 2005:208) and excluded from the regression models which then leave seven industry dummies being regressed.

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in corporate governance practice. Accordingly, the causality relationship between firms' corporate governance practice and performance would be identified as being endogenously determined [see Agrawal and Knoeber, (1996); Bhagat et al., (2002)] rather than the impact of firms' implementation of certain internal corporate governance measures.

Drobetz et al., (2004) employed firm's size, leverage ratio, stock exchange listing and industry dummy to ensure that endogeneity problems would not affect the robustness and validity of their study of the impact of firms' corporate governance rating on firm value. Similarly, Black et al., (2006) applied firm size and leverage ratio in their investigation of the impact of Korean firms corporate governance practice on firm performance. Following Drobetz et al., (2004) and Black et al., (2006), the potential impact of the endogeneity problem in this study is controlled with the utilisation of the respective control variables. In addition, the substantial changes in Malaysian listed firms' corporate governance practices have been mainly driven by exogenous influences, namely, Malaysian Securities Commission regulations and MBSB Listing Requirements in 2001 (see KLSE and PwC, 2002). Hence, the endogeneity problem should not affect this research's examination of the impact of firms' internal corporate governance practice on firm value.

The use of firm size, such as total assets (**NTASET**), as a control variable, will capture the impact of greater firm resources on facilitating firms' productivity level and their managements' efficiency to promote firm value creation (see, for instance Hansen and Wernerfelt, 1989). In addition, firm's leverage ratio (**NDEQ**) indicates the extent of its capital gearing, namely, its reliance on debts financing over equity financing (see Bhandari, 1988). The use of debts financing will enhance firm performance when banks and/or financial institutions closely

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monitor management's procurement activities (see, for instance, Shleifer and Vishny, 1997; Drobetz, 2004; Chang Aik Leng and Abu Mansor, 2005).

Industry effects (**INDS**) are examined to ensure adequate conceptualisation of the industrial environment in which the firms under study operate and compete to prevent misleading interpretation (Dess et al., 1990). For instance, an industry's profitability level can explain the variation in profit of the sampled firms (Beard and Dess, 1981). Moreover, industry effects allow further insight and understanding of the behaviour of firms from diverse industries since certain industries may be confined to certain projections (Hirsch, 1975). Accordingly, the stratification of research samples by industry will facilitate consistent examination of relationships among the variables under consideration. Spurious results can be moderated and findings more accurately interpreted (Rosenberg, 1968). The variation in firm performance in different industries may be due to how firms in the same industry develop competitive strategies, and inherent uncertainty in a certain industry may affect the firm's risk exposure and hence performance (see, for instance, Mauri and Michaels, 1998; Cockburn and Griliches, 1988; Lemmon and Lins, 2003)

With respect to non-executive director remuneration (**NREMU**), Main et al., (1996) found that their pay level aligns with firm performance when a share option scheme is part of their compensation scheme. A survey conducted by KLSE and PwC (2002) reported that non-executive directors of public listed firms were not satisfied with their current remuneration payment and indicated that their performance would be enhanced with the setting of their pay level according to market rate.

Ownership of substantial shareholdings²⁸, namely, by individuals, private companies, government agencies, institutional investors and public listed companies has been found to enhance incentives of the respective groups of shareholders and hence better firm performance (see, for instance, Mitton, 2002) [NINDPV; NINSTL]. In particular, Gomez and Jomo (1998) linked the presence of Malay directors on Malaysian corporations' board of directors to firm's strategic means of accessing external resources given the directors potential links with the government and/or ruling party.

5.1.2 *Board of Directors' Leadership and Firm Performance*

In Chapter 3 (see Section 3.4.3), the significance of the board chairman's independence was emphasised. The Chairman's duties encompass being the board's leader and setting up and administrating board meetings, i.e. determining their agendas, distributing information prior and post meetings, and establishing an environment conducive to easy and fair debate on critical issues amongst board members and management), and directing the company's future prospects and policies' establishment [see, for example, Fama and Jensen (1983a); Dayton (1984); Kose and Senbet (1998)]. In addition, Eisenhardt (1988) found that a board of directors that is led by a founder-chairman will have an influence on the board structure and process.

In light of the above, the ensuing hypotheses are proposed to evaluate the contribution of the independence of the board's chairman to firm value:

HBL 1: The appointment of an independent director as board chairman will have a positive impact on firm performance.

²⁸ According to Lemmon and Lins (2003), the equity holding of 5% or more shares in the firm.

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HBL 2: The appointment of a senior independent director as board chairman will have a positive impact on firm performance.

HBL 3: The appointment of the founder as board chairman will have an impact on firm performance.

HBL 4: The appointment of a non-executive director as board chairman will have an impact on firm performance.

HBL 5: The appointment of a family member as board chairman will have an impact on firm performance.

HBL 6: The separate appointment of the firm's board chairman and chief executive officer will have a positive impact on firm performance.

Importantly, hypotheses HBL 3 and HBL 5 will be observed together with HBL 6. According to Villalonga and Amit (2006), when the founder of the company does not serve as the CEO or Chairman of the company (i.e. where the CEO is a non-family member), family influence on the firm's management may not add to firm value. They also found that the appointment of a founder family member as the firm's CEO or Chairman is detrimental to firm value.

Specifically, the explanatory variables for the ordinary least square (OLS) model of board leadership and firm performance are represented by:

- (i) Binary code of 1 or 0 otherwise when an independent director has chaired the board of directors (CHINED),
- (ii) Binary code of 1 or 0 otherwise when a senior independent director has chaired the board of directors (CHSINED),
- (iii) Binary code of 1 or 0 otherwise when a founder has chaired the board of directors (CHFOUND),
- (iv) Binary code of 1 or 0 otherwise when a non-executive director has chaired the board of directors (CHNED),
- (v) Binary code of 1 or 0 otherwise when a family-member director has chaired the board of directors (CHFAM), and

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- (vi) Binary code of 1 or 0 otherwise when a non-executive director has chaired the board of directors and where there has been a separate appointment of the firms' board chairman and chief executive officer (SEPCEO).

Further, the board leadership research model is controlled by:

- (i) Firm Size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) The proportion of family directors on the board (NFAMDI),
- (iv) The proportion of independent directors on the board (NINED),
- (v) The proportion of specific foreign directors (i.e. from European countries, the USA, Australia, New Zealand and Singapore)²⁹ on the board (NFORS),
- (vi) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV), and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],
- (vii) Size of board of directors (NBDSZ), and
- (viii) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]³⁰.

Board leadership hypotheses are empirically examined by the following **OLS 2** model. In particular, the OLS 2(i) model will empirically examine hypothesis HBL 1:

$$\text{Firm Performance}_{it} = \alpha + \beta_1 \text{CHINED} + \sum_{k=1}^8 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j$$

²⁹ These include, foreign directors from European countries (i.e. the UK, France, Germany, Denmark and Switzerland), the US, Australia and Singapore in light of their corporate governance standard ranking [See Cornelius, 2005: FTSE, 2005]

³⁰ See ibid 27.

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In addition, the OLS 2(ii) model will empirically examine hypothesis HBL 2:

$$Firm\ Performance_{it} = \alpha + \beta_2 CHSINED + \sum_{k=1}^8 Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \varepsilon_j$$

The OLS 2(iii) model will empirically test hypotheses HBL 3 and HBL 6:

$$Firm\ Performance_{it} = \alpha + \beta_3 CHFOUD + \beta_4 SEPCEO + \sum_{k=1}^8 Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \varepsilon_j$$

Moreover, the OLS 2(iv) model will empirically investigate hypothesis HBL 4:

$$Firm\ Performance_{it} = \alpha + \beta_5 CHNED + \sum_{k=1}^8 Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \varepsilon_j$$

The OLS 2(v) model will empirically examine hypotheses HBL 5 and HBL 6:

$$Firm\ Performance_{it} = \alpha + \beta_6 CHFAM + \beta_7 SEPCEO + \sum_{k=1}^8 Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \varepsilon_j$$

Whilst the OLS 2(vi) model will evaluate hypothesis HBL 6:

$$Firm\ Performance_{it} = \alpha + \beta_7 SEPCEO + \sum_{k=1}^8 Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \varepsilon_j$$

The inclusion of foreign director (**NFOR**S) as control variable in research model OLS 2 is motivated by the potential presence of foreign directors from countries with a strong corporate governance system, to add to the firm's governance practices, given these foreign directors' governance experience in their own country (see, for example, Oxelheim and Randoy, 2003; Black et al., 2006). In addition, the appointment of foreign director(s) on the firm's board also signified foreign investors need to ensure that their substantial investments in the firm are being appropriately managed, especially in developing economies which are new to open markets systems (Ramaswamy and Li, 2001).

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As regards to the impact of board size on firm performance, Yermack (1996) found that a small board of directors facilitates communication amongst board members and hence decision-making. His findings supports the contention by Lipton and Lorsch (1992) and Jensen (1993) that large boards of directors may not be able to exchange ideas and opinions efficiently given the complexity of firms' activities that they may have to evaluate within a specific period of time. On the other hand, the establishment of a large board of directors to accommodate the firm's human capital needs for financial and non-financial knowledge and skills is imperative for effective board decision-making (see, for example, Beasley, 1996; Holland and Jackson, 1998; Castanias and Helfat, 2001).

5.1.3 *Board of Directors' Competency and Firm Performance*

One of the key responsibilities of a board of directors is to conduct appropriate oversight of a firm's reporting practice, such that the production of the statutory report complies with the Securities Commission, Stock Exchange and related and relevant accounting standards and other legal requirements (see Beasley et al., 2000). Westphal and Zajac (1995) argued that an individual's educational level has influences on his/her ability to process complex information. According to the resource-dependency view, the appointment of outside directors establishes the firm's access to external resources, given such directors' broad industry experience and/or connections in the external environment (see for examples Pfeffer and Salancik, 1978; Boyd, 1990; Abbott et al., 2004; Kor and Mahoney, 2005; Kula, 2005).

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Lee et al., (1999) found the appointment of directors with a financial background, namely in commercial banking, insurance and investment management has an impact on the firm's ease of access to financial markets. Shivdasani and Yermack (1999) used the type of occupation of newly appointed directors to examine the CEO's role in the director election process and its impact on firms' cumulative abnormal return. They identified the potential for academics, lawyers, commercial bankers, investment bankers, professionals and consultants to be selected as CEO board of director nominees.

Knapp (1987) also reported that directors with managerial experience in public firms have greater awareness of accounting and reporting issues. Moreover, studies have indicated that a person's educational level has an impact on his/her ability to perform corporate innovations and strategic changes in the organisation (Bantel and Jackson, 1989; Wiersema and Bantel, 1992). In addition, Baysinger and Butler (1985) and Verschoor (1993) noted the significance of legal experts on the board of directors to provide advice and counsel on legal rules and regulatory requirements.

Investigation of the impact of board of directors' competency on firm performance in this study is based on the following hypotheses:

HBKNOW 1: The proportion of board of directors with higher education will have an impact on firm performance.

HBKNOW 2: The proportion of directors with accounting, finance, law and chartered secretary knowledge and skills will have an impact on firm performance.

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Specifically, the explanatory variables for the board competency model are as follows:

- (i) The proportion of directors with a Bachelor Degree (NDEG), Master Degree (NMASK), Professional qualification (NPROFL) and Doctorate (NPHD) and
- (ii) The proportion of directors with accounting (NACTGK), finance (NFINK), business (NBUSK), law (NLAWK), executive management programme (NEXEPROG)³¹, and company secretary (NCHASEC) qualifications.

In particular, the research model **OLS 3** is developed to empirically examine the respective board of directors' competency hypotheses. Accordingly, the OLS 3 (i) model will empirically examine the relationship between board of directors' educational level and firm performance:

$$\text{Firm Performance}_{it} = \alpha + \beta_1 \text{NDEG} + \beta_2 \text{NMASK} + \beta_3 \text{NPROFL} + \beta_4 \text{NPHD} + \sum_{k=1}^9 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j$$

The control variables employed in the research model OLS 3 (i) are:

- (i) Firm Size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) Proportion of family directors on the board (NFAMDI),
- (iv) The proportion of independent directors on the board (NINED),
- (v) The proportion of specific foreign directors (i.e. from European countries, the USA, Australia, New Zealand and Singapore)³² on the board (NFORS),
- (vi) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV), and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],
- (vii) Binary coding of 1 or 0 otherwise when the firm's external auditor is one of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUF5],

³¹ For instance the executive programme organised by Harvard, Stanford, INSEAD and London Business Schools, etc. (see Dionne and Triki, 2005).

³² These include, foreign directors from European countries (i.e. the UK, France, Germany, Denmark and Switzerland), the US, Australia and Singapore in light of their corporate governance standard ranking [See Cornelius, 2005; FTSE, 2005].

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- (viii) Size of board of directors (NBDSZ), and
- (ix) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]³³.

Whilst, the OLS 3(ii) model will empirically test the relationship between board of directors' areas of expertise and firm performance:

$$\text{Firm Performance}_{it} = \alpha + \beta_1 \text{NACTGK} + \beta_2 \text{FINK} + \beta_3 \text{NBUSK} + \beta_4 \text{NLAWK} + \beta_5 \text{NEXEP} + \beta_6 \text{NCHASEC} + \sum_{k=1}^5 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j$$

Respectively, OLS 3(ii) model is controlled by the following variables:

- (i) Firm Size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) Proportion of family directors on the board (NFAMDI),
- (iv) Binary coding of 1 or 0 otherwise when the firm's external auditor is one of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUF5],
- (v) Size of board of directors (NBDSZ), and
- (vi) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining].

³³ See *ibid* 27.

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(PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]³⁴.

The employment of control variable of firm's appointment of big 5 audit firms as external auditors (**AUDF5**) has been linked with a firm's quality of financial reporting practice, auditing process and corporate governance implementation [see, for example, Beattie and Fearnley, (1995); Francis et al., (1999); Carcello et al., (2002); Maijoor and Vanstraelen, (2006)], and audit committee effectiveness (see, Carcello et al., 2000).

In particular, the quality and reliability of big 5 audit firms' services [see McConnell, (1984); Eichenseher, and Shields, (1985)] has been reported to increase the audit committee's support of auditors' assessment of the firm's financial circumstances (which will enhance auditors' independence and effectiveness) and subsequently audit committee members' influence on the board's assessment of the merits of management's financial and strategic investment planning (see, Knapp, 1987). Further, according to Eichenseher and Shields (1985), the quality of the audit services of big 8 firms reduces potential litigation penalties made on firms.

5.2 Board Subcommittees and Firm Performance

The establishment of the audit committee, nomination committee and remuneration committee has been linked with the need to implement appropriate monitoring of a firm's financial management and reporting practice (McDaniel et al., 2002), top management candidature selection (Dalton et al., 1998), and objective and fair assessment of executives' compensation package and performance (Carson, 2002) respectively. The subcommittees' specific functions

³⁴ See *ibid* 27.

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represent the board's critical oversight duties in the firm and will impact on the board's evaluation of and decisions on issue relevant to them, i.e. the firm's financial circumstances and board members' and management's contribution to firm activities and, hence, firm value creation (see Zahra and Pearce, 1989). McKinsey's 2002 survey of global investor opinions on firm corporate governance practice found that, on average, investors were willing to pay a 12% premium on the share of firms which exhibited high governance standards.

According to Kirk and Siegel (1996) and Klein, (1998) the formation of the board subcommittees can assist in overcoming the information gap problem between managers and owners or owner-managers and minority shareholders (Haron et al., 2005). For instance, audit committee effectiveness in overseeing a firm's financial reporting practice will have a subsequent impact on the supply of reliable and credible information to shareholders (Blue Ribbon Committee, 1999). Given executives' control of internal information and their depth of knowledge of the firm's industry and business, Ezammel and Watson (1998) argued that managers' accountability to make decisions that are in the best interests of shareholders has to be monitored.

For instance, the managers' lack of ownership of firm shares creates a conflict of interests between managers' and shareholders' financial goals (see, Jensen and Meckling, 1976). Furthermore, managers have distinct firm internal information advantage in comparison to shareholders [see, Fama and Jensen, 1983 (a) and (b)]. In consideration of the asymmetry of information between owners and managers, Ezammel and Watson (1998) emphasised the importance of monitoring managers' accountability in supplying appropriate and sufficient

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information about the firm's activities. In particular, the transparency and quality of information supplied by managers will affect shareholders' abilities to make informed economic decision-making (see, Nowak and McCabe, 2003).

Notably, the effectiveness of the board's sub-committees to perform their duties objectively and impartially is affected by their composition, structure and characteristics (see, for example, Greenbury's Report, 1998; Abbott et al., 2000; Higgs Report 2003). For instance, Bédard et al. (2002) contended that an independent audit committee will strengthen the influence of independent director views and judgement as well as increase their active participation in management discussion. Further, the nomination committee's selection of board candidates will also have an impact on board oversight performance (Shivdasani and Yermack, 1998).

In addition, an independent remuneration committee will facilitate objective evaluation of executive directors' performance and compensation, given the level of firm performance achieved by them (Carson, 2002). It should also be mentioned that board members are paid an additional fee for being members of the board's subcommittees as indicated in companies' annual reports. The following sections will develop the research hypotheses and models for audit, nomination and remuneration committees.

5.2.1 *Audit Committee Attributes and Firm Performance*

In this section, three audit committee attributes, namely, independence, leadership and competency, are examined to develop their respective link with firm performance

5.2.1.1 **Audit Committee Independence and Firm Performance**

As emphasised earlier in Chapter 3, subsection 3.6, and more specifically in subsection 3.6.1, the strength of audit committee members' impartial views and judgement and attention to details, critical in overseeing a firm's financial position, reporting and auditing practice, rely on the committee's majority composition of independent outside directors (Abbott et al., 2000). Further, it has been argued that the presence of non-independent directors, such as top executives and their affiliates, may prevent committee members from easily and freely expressing their real concerns about current circumstances affecting the company (Bédard et al., 2004). To ensure the quality, reliability and credibility of audit committee oversight performance, and vigilance regarding circumstances affecting shareholders' interests, it has been highly recommended that the audit committee should comprise at least one member with an accounting and financial background (DeZoort, 1998), preferably an accounting practitioner. According to McMullen and Raghunandan (1996), the latter's presence will ensure cognisant assessment of a firm's financial reporting, accounting and auditing procedures.

In addition, MBSB Listing Rulings 2001, MCCG 2001 and the Smith Report 2003 (Para 3.10) emphasise the importance of an audit committee's independent members convening at least one meeting in a year with the external auditor, without the presence of management representatives. This practice is encouraged to establish an objective and impartial assessment of the firm's financial reporting practice, auditing process and financial position as well as increase auditor independence and hence effectiveness [see for instance, BRC (1999); Williams (2007)].

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Furthermore, in Para 15.17 of Chapter 15 of the MBSB Listing Rulings, the Stock Exchange requires audit committee members to report to the Exchange any company's failure to resolve appropriately those issues that have been raised by the committee to the firm's board, which has resulted in the company breaching the MBSB listing requirements. Further, the effectiveness and independence of the judgements of audit committee independent member(s) and the auditor will be enhanced if the two parties are able to conduct a meeting without the presence of executive members of the company (see Kirk and Siegel, 1996). In particular, Para 15.18(f) of Chapter 15 of the MBSB listing requirements and MCCG (2001: Best Practices Guide) stipulates such meetings as part of the rights of audit committee members. Hence, a company's disclosure of its implementation of Para 15.17 and Para 15.18(f) in the audit committee report signifies its commitment to ensure orderly and independent reviews and judgements of its financial position, reporting and auditing practice.

To assess audit committee independence influence on firm performance, the following research hypotheses are proposed:

HACIND 1: The audit committee's composition entirely of independent directors will have a positive impact on firm performance.

HACIND 2: The domination of an audit committee by independent directors will have a positive impact on firm performance.

HACIND 3: The audit committee's majority composition of by independent directors will have a positive impact on firm performance.

HACIND 4: The presence of a senior independent director on the audit committee will have a positive impact on firm performance.

HACIND 5: The presence of at least one independent audit committee member with practising accountant experience will have a positive impact on firm performance.

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HACIND 6: The proportion of audit committee's members with practising accountant experience will have a positive impact on firm performance.

HACIND 7: The presence of an audit committee chairman with practising accountant experience will have a positive impact on firm performance.

HACIND 8: The exclusion of Chief Executive Director, Chief Financial Officer and Managing Director from audit committee membership will have a positive impact on firm performance.

HACIND 9: The presence of a family member director on the audit committee will have an impact on firm performance.

HACIND 10: The convening of audit committee meetings between the audit committee's independent directors and the external auditor without the presence of executive members will have a positive impact on firm performance.

HACIND 11: The disclosure in the audit committee report of the committee's authority to report firm violation of MBSB listing requirements³⁵ will have an impact on firm performance.

Notably, the research model for HACIND 1 is developed by also examining the model with HACIND 4, 5, 7 and 10. In addition, the research models for HACIND 2 and 3 are similar to research model HACIND 1 and further investigate HACIND 8 and 9. Raghunandan et al., (2001) contended that the significance of the independence and effectiveness of an audit committee is enhanced with the appointment of at least one audit committee member with accounting and finance background. The establishment of an independent audit committee with relevant competency will enhance audit committee efficiency in performing auditing and internal control evaluation tasks.

³⁵ Where the issues raised by the audit committee to the firm's board have not been resolved satisfactorily, resulting in the firm's breach of MBSB listing requirements.

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Explanatory variables for the audit committee independence model are represented by:

- (i) Binary coding of 1 or 0 otherwise when the audit committee is solely comprised of independent directors (AUDF),
- (ii) Binary coding of 1 or 0 otherwise when the audit committee's composition's comprised of majority independent directors (AUGMJ),
- (iii) Binary coding of 1 or 0 otherwise when the audit committee's composition's comprised of majority independent directors (AUDMJ),
- (iv) Binary coding of 1 or 0 otherwise when there is a senior independent director on the audit committee (AC SIN),
- (v) Binary coding of 1 or 0 otherwise when at least one of the audit committee's independent members has accounting and/or financial knowledge and skills (ACPI),
- (vi) Binary coding of 1 or 0 otherwise when at least one audit committee's members has practising accountant experience (ACPACT),
- (vii) Binary coding of 1 or 0 otherwise when the chairman of the audit committee has experience as a practising accountant (APACH),
- (viii) Binary coding of 1 or 0 otherwise when the chief executive director, chief financial officer and/or managing director is not an audit committee member (AXCEO),
- (ix) Binary coding of 1 or 0 otherwise when there is the presence of a family director on the audit committee (ACFAM),
- (x) Binary coding of 1 or 0 otherwise when independent committee members convene at least one meeting with the external auditor without the presence of executive officers (MTEXT),
- (xi) Binary coding of 1 or 0 otherwise when the firm has disclosed the right of the audit committee to report to the Stock Exchange any firm breaching Exchange and other regulatory rules (RBRE).

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Specifically, research model **OLS 4** is proposed to represent the relationship between audit committee independence and firm performance. In particular, OLS 4(i) will empirically test the research hypotheses HACIND 1, 4, 5, 7, 10 and 11 respectively:

$$\begin{aligned} \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{AUDF} + \beta_1 \text{ACSIN} + \beta_2 \text{ACPI} + \beta_3 \text{APACH} + \beta_4 \text{MTEXT} + \beta_5 \text{RBRE} \\ & + \sum_{k=1}^7 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j \end{aligned}$$

In addition, OLS 4(ii) will empirically investigate the research hypotheses HACIND 2, 4, 5,6,7,8,9,10 and 11:

$$\begin{aligned} \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{AUGMJ} + \beta_1 \text{ACSIN} + \beta_2 \text{ACPI} + \beta_3 \text{ACPACT} + \beta_4 \text{APACH} + \\ & \beta_5 \text{AXCEO} + \beta_6 \text{ACFAM} + \beta_7 \text{MTEXT} + \beta_8 \text{RBRE} + \\ & \sum_{k=1}^4 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j \end{aligned}$$

Further, OLS 4(iii) will empirically evaluate the hypotheses HACIND 3, 4, 5,6,7,8,9,10 and 11,

$$\begin{aligned} \text{Firm Performance}_{it} = & \alpha + \beta_1 \text{AUDMJ} + \beta_1 \text{ACSIN} + \beta_2 \text{ACPI} + \beta_3 \text{ACPACT} + \beta_4 \text{APACH} + \\ & \beta_5 \text{AXCEO} + \beta_6 \text{ACFAM} + \beta_7 \text{MTEXT} + \beta_8 \text{RBRE} + \\ & \sum_{k=1}^4 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j \end{aligned}$$

The audit committee independence model is controlled by the following variables:

- (i) Firm Size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) Attendance rate of audit committee members at the committee's meetings (NATEND),
- (iv) The proportion of independent directors on the board (NINED),
- (v) The proportion of family director members with accounting and finance knowledge and skills (NFACF),
- (vi) The proportion of independent directors with accounting and financial knowledge and skill on the board (NINACF),

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- (vii) The proportion of family members on the board (NFAMDI) and
- (viii) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]³⁶.

Specifically, control variables (i), (ii), (iii), (iv), (v), (vi), (vii) and (viii) are employed in the OLS 4(i) model. On the other hand, OLS 4(ii) and OLS 4(iii) models are controlled by control variables (i), (ii), (iii), (iv) and (viii).

The attendance of audit committee members at committee meetings (**NATEND**) signifies their commitment to allocate significant time to audit committee oversight activities (PwC, 2003; Smith Report, 2003). However, to be effective, audit committee members need to perform their financial oversight duties with vigilance and diligence (see Bedard et al., 2004). In addition, Klein [2002 (a)] argued that audit committee independence is affected by overall board independence.

Moreover, the competency of family-member directors to manage the firm appropriately may have an impact on firm performance (see, for instance, Barney et al., 2001; MacAvoy and Millstein, 2002). Jensen and Fuller (2002) argue that the presence of at least one financial expert on the firm's board is important to ensure appropriate board decisions on the financial position of the firm. Potentially, the appointment of family members with financial knowledge and skills

³⁶ See *ibid* 27.

(NFACF) may enhance the board's financial oversight judgement and shareholders' best interests or' on the contrary, increase the influence of family-member directors over the board's strategic decisions. Considerably, such consequences would have an impact on audit committee's decision-making since firm's ultimate decisions are made at the board level (see Fama and Jensen, 1983 (a); Boone et al., 2007]

5.2.1.2 **Audit Committee Leadership and Firm Performance**

Malaysia Bourse Securities Limited (MBSB) in its listing requirements 2001 has made it mandatory for listed issuers to appoint an audit committee chairman from amongst its independent members. In particular, the Exchange's rulings require the position of chairman of the audit committee to be held by an independent director so as to ensure proper conduct of committee meeting procedures and sufficient attention is directed to material issues (see Chapter 15 of MBSB Listing Requirements, 2001). In addition, the role of audit committee chairman should include the appointment of audit committee members (see Para 3.3, Smith Report, 2003), and in setting the frequency and timing of the committee's meetings (see Para 3.5, Smith Report, 2003). Notably, the Smith Report 2003 emphasised the need for the audit committee chairman to commit a significant amount of time to perform audit committee duties (see Para 1.3 of Smith Report).

The Report also noted the importance of the audit committee chairman's presence at the annual general meeting (AGM) of the company, particularly to clarify matters regarding the audit committee's activities and performance of duties within the scope of its responsibilities during the financial year period (see Para. 6.3 of the Smith Report, 2003). Kirk and Siegel (1996) and

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Kirk (2000) also argue that, the audit committee chairman plays an important role in improving the communication gap between the board of directors and the auditor. Moreover, the audit committee's effectiveness will depend on members', especially the committee chairman, regular and continuing communication with the firm's key people involved in the firm's governance, namely, the board's chairman, external auditor lead partner, and internal auditor (Smith Report, 2003: Para 3.9).

Moreover, the presence of audit committee members with an accounting and finance background has been linked with better performance of the audit committee's financial oversight duties and judgements (DeZoort, 1998, and McDaniel et al., 2002). Also, the presence of audit committee members who possess corporate managerial experience has been linked with their increased participation in corporate oversight duties (Knapp, 1987).

Given the above-mentioned arguments, the following hypotheses relating to the impact of audit committee chairman attributes on firm performance are proposed:

HACL 1: The appointment of a senior independent director as chairman of the audit committee will have a positive impact on firm performance (ACHSIN),

HACL 2: The appointment of an audit committee chairman who possesses accounting and/or financial knowledge and skills will have a positive impact on firm performance (ACHACF),

HACL 3: The appointment of an audit committee chairman who possesses business and management knowledge and skills³⁷ will have an impact on firm performance (ACHBUS),

HACL 4: The appointment of an audit committee chairman who has practising accountant experience will have a positive impact on firm performance (ACHP),

³⁷ This includes an individual who has business and management related degrees, experience as a CEO, Chief Operating Officer, Chairman of other companies and/or is an executive of other companies (See Carcello et al., 2006).

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HACL 5: The appointment of a senior independent director, who has practising accountant experience, as the audit committee chairman will have a positive impact on firm performance (ACHSINP),

The explanatory variables for the testing of hypotheses and research models are represented by:

- (i) Binary coding of 1 or 0 otherwise when a senior independent director is appointed as the committee's chairman (ACHSIN),
- (ii) Binary coding of 1 or 0 otherwise when the audit committee chairman possesses accounting and finance knowledge and skills (ACHACF),
- (iii) Binary coding of 1 or 0 otherwise when the audit committee chairman possesses business and management knowledge and skills (ACHBUS),
- (iv) Binary coding of 1 or 0 otherwise when the audit committee chairman possesses practising accountant experience (AHP) and
- (v) Binary coding of 1 or 0 otherwise when the committee is chaired by a senior independent director who has practising accountant experience (ACHSINP)

Accordingly, the control variables for the audit committee leadership research models are:

- (i) Firm Size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) The presence of a family member director on the audit committee (ACFAM),
- (iv) The proportion of family directors on the firm's board (NFAMD),
- (v) The proportion of independent directors with accounting and financial knowledge and skill on the board (INACF),
- (vi) The proportion of audit committee members with practising accountant experience (NAPACT),
- (vii) The proportion of independent directors on the board (NINED),
- (viii) The appointment of an independent director as a board of director's chairman (CHINED),
- (ix) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV) and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],

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- (x) Binary coding of 1 or 0 otherwise when the firm's external auditor is one of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUF5] and,
- (xi) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]<sup>38</sup>.

Audit committee leadership hypotheses are empirically examined by the research model **OLS 5**.

In particular, the hypothesis HACL 1 will be empirically examined by OLS 5(i):

$$\mathbf{Firm\ Performance}_{it} = \alpha + \beta_1 \mathbf{ACHSIN} + \sum_{k=1}^{11} \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \epsilon_j$$

The OLS 5(ii) model will empirically investigate hypothesis HACL 2:

$$\mathbf{Firm\ Performance}_{it} = \alpha + \beta_2 \mathbf{ACHACF} + \sum_{k=1}^{11} \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \epsilon_j$$

Whilst the OLS 5(iii) model will empirically examine hypothesis HACL 3:

$$\mathbf{Firm\ Performance}_{it} = \alpha + \beta_3 \mathbf{ACHBUS} + \sum_{k=1}^{11} \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \epsilon_j$$

The OLS 5(iv) model will empirically investigate hypothesis HACL 4:

$$\mathbf{Firm\ Performance}_{it} = \alpha + \beta_4 \mathbf{ACHP} + \sum_{k=1}^{11} \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \epsilon_j$$

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<sup>38</sup> See ibid 27.

While the OLS 5(v) model will empirically evaluate hypothesis HACL 5:

$$Firm\ Performance_{it} = \alpha + \beta_s ACHSINP + \sum_{k=1}^{11} Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \varepsilon_j$$

### 5.2.1.3 Audit Committee Competency and Firm Performance

The imperativeness of audit committee members possessing accounting and financial knowledge and skills has been linked with their significance in assisting committee members' appropriate and effective performance of financial oversight duties, namely, the evaluation of the firm's financial reporting and auditing process [see, for instance, Bonner and Lewis (1990); BRC (1999); Abbott et al. (2000) and (2004); Carcello et al., 2006]. Further, the possession of theoretical accounting knowledge without practical experience may not be as effective as possessing and acquiring both skills (McDaniel et al., 2002). Knapp (1987) showed, audit committee members' managerial experience in public firms enhanced their knowledge of relevant accounting and reporting issues important for better management of public corporations.

In addition, Baysinger and Butler (1985) and DeZoort and Salterio (2001) indicated that the presence of legal experts on audit committees will add value to the committee's comprehension of the implication and implementation of financial reporting rules and regulations. Moreover, the Higg Report (2003) recognised the positive impact of the knowledge and experience of the company secretary on a firm's business procedures, operations and corporate governance. Such knowledge is particularly valuable to audit committee members for understanding a firm's internal processes and accessing a firms' internal information from the appropriate sources (see the Smith Report, 2003).



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In light of the above the following hypotheses are proposed to examine the impact of audit committee competency on firm performance:

HACKNOW 1: The proportion of audit committee members with accounting and finance knowledge and skills will have a positive impact on firm performance,

HACKNOW 2: The proportion of audit committee members with practising accountant experience will have a positive impact on firm performance,

HACKNOW 3: The proportion of audit committee members with business and/or management experience will have an impact on firm performance<sup>39</sup>,

HACKNOW 4: The proportion of audit committee members with a law background will have an impact on firm performance, and

HACKNOW 5: The proportion of audit committee members with company secretary experience will have an impact on firm performance.

The explanatory variables for the audit competency models are as follows,

- (i) The proportion of audit committee members with accounting and/or finance knowledge and skills (NAUACF),
- (ii) The proportion of audit committee members with practising accountant experience (NAPACT),
- (iii) The proportion of audit committee members with business and management knowledge and skills (NACBUS),
- (iv) The proportion of audit committee members with a law qualification (NACLAW), and
- (v) The proportion of audit committee members with company secretary experience (NACSEC).

Further, the research model is controlled by the following variables:

- (i) Firm Size as measured by total asset (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),

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<sup>39</sup> This includes individuals who have a business and management related degree, experience as a CEO, Chief Operating Officer, Chairman of other companies and/or is an executive of other companies (see Carcello et al., 2006).

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- (iii) The proportion of board of director members with accounting knowledge and skills (NACTGK),
- (iv) The proportion of board of director members with finance knowledge and skills (NFINK),
- (v) The proportion of family members on the board (NFAMDI),
- (vi) Binary coding of 1 or 0 otherwise when the firm's external auditor is one of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUF5],
- (vii) Size of board of directors (NBDSZ), and
- (viii) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]<sup>40</sup>.

The research model OLS 6 will empirically examine hypotheses HACKNOW 1, 2, 3, 4 and 5:

$$\text{Firm Performance}_{ii} = \alpha + \beta_1 \text{NAUACF} + \beta_2 \text{NAPACT} + \beta_3 \text{NACBUS} + \beta_4 \text{NACLAW} + \beta_5 \text{NACSEC} + \sum_{k=1}^8 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j$$

### 5.2.2 *Nomination Committee and Remuneration Committee*

The formation of a nomination and remuneration committee is part of Corporate Governance Best Practices and a voluntary practice for Malaysian public listed corporations (see MCCG, 2001; MBSB, 2001). However, companies need to disclose and give specific reasons for their non-compliance with best practices' recommendations (see Para 15.26 of Malaysia Bourse Listing Rulings). To further enrich the study of the nomination committee's impact on firm

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<sup>40</sup> See *ibid* 27

performance, the research hypotheses are designed to examine the effect of the board subcommittee's establishment and composition on firm performance.

#### 5.2.2.1 **Nomination Committee and Firm Performance**

The formal establishment of a nomination committee in the firm has been linked with executives' preference to nominate directors who are less inclined to monitor their activities (Jensen, 1993). However, the formation of a nomination committee should ensure implementation of an objective and impartial selection process of executives' nominees (Vafeas, 1999a). The committee's duties extend to formally evaluating the performance of board members and hence their service period in the firm [see MCCG, (2001); Cheah, (2003); the Higgs Report (2003); Mehrotra, (2003)], and establishing an organised and systematic search for knowledgeable and experienced independent directors (Gregory, 2001).

With regard to the nomination committee composition and leadership, both MCCG (2001) and the Higg Report 2003 recommend a high independent directors' presence and the appointment of an independent nomination committee chairman. According to Vicknair et al., (1993), the nomination committee's independent composition and leadership will reduce management's inherent domination of and influence over the selection process of directors. Moreover, the independence of the nomination committee has an impact on its assessment of the firm's governance procedures, emphasising the importance of independent directors' representation on the board (Andrew, 1987). Shivdasani and Yermack (1999) also observed a relationship between the announcement of independent director appointments and significantly low stock price movement when the CEO is one of the members of the nomination committee. Tejada (1997)

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also showed that the presence of a top executive on the nomination committee may affect outside directors' choice of nominees to the board of directors, given executives' influence over their future employment opportunities.

To assess the implications of nomination committee establishment and attributes on firm performance, the following research hypotheses are proposed:

HNC 1: The establishment of a nomination committee in the firm will have a positive impact on firm performance,

HNC 2: The proportion of independent directors on the nomination committee will have a positive impact on firm performance,

HNC 3: The presence of senior independent directors on the nomination committee will have an impact on firm performance,

HNC 4: The presence of a family member(s) on the nomination committee will have an impact on firm performance,

HNC 5: The exclusion of the CEO, CFO or Managing Director from nomination committee membership will have a positive impact on firm performance,

HNC 6: The chairing of the nomination committee by an independent director will have a positive impact on firm performance,

HNC 7: The chairing of the nomination committee by a senior independent director will have an impact on firm performance.

Specifically, the explanatory variable for the nomination committee establishment model is represented by a binary coding of 1 or 0 otherwise when the firm has established such committee (NCEXIST). This research model also investigated the presence of the following corporate governance variables:

- (i) Proportion of independent directors on the board (NINED),
- (ii) Binary coding of 1 or 0 otherwise when there is a senior independent director on the board (SRINED),

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- (iii) Binary coding of 1 or 0 otherwise when the CEO or Managing Director is not a board member (EXCEO),
- (iv) Binary coding of 1 or 0 otherwise when an independent director has chaired the board of directors (CHINED),
- (v) Binary coding of 1 or 0 otherwise when the founder was a board member (FOUD),
- (vi) The proportion of family members on the board (NFAMDI).

The following control variables will also be employed in the nomination committee establishment research model,

- (i) Firm size as measured by total assets (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) The proportion of specific foreign directors (i.e. from European countries, the USA, Australia, New Zealand and Singapore)<sup>41</sup> on the board (NFORS),
- (iv) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV) and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],
- (v) Size of board of directors (NBDSZ) and
- (vi) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]<sup>42</sup>.

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<sup>41</sup> This represents foreign directors from European countries (i.e. the UK, France, Germany, Denmark and Switzerland), the US, Australia and Singapore in consideration of their corporate governance standard ranking [see Cornelius, 2005; FTSE, 2005].

<sup>42</sup> See *ibid* 27.

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The testing of HNC 1 on the impact regarding nomination committee establishment on firm performance will be empirically examined by the research model OLS 7 as follows:

$$\begin{aligned} \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{NCEXIST} + \beta_1 \text{NINED} + \beta_2 \text{SRINED} + \beta_3 \text{EXCEO} + \beta_4 \text{CHINED} + \\ & \beta_5 \text{FOUD} + \beta_6 \text{NFAMDI} + \sum_{k=1}^6 \text{Control Variables} + \sum_{m=1}^8 \text{Industry Dummy} \\ & + \varepsilon_j \end{aligned}$$

For testing of HNC 2, 3, 4, 5, 6 and 7, the following represent the explanatory variables for the nomination committee attributes research model:

- (i) Proportion of independent directors on the nomination committee (NCINED),
- (ii) Binary coding of 1 or 0 otherwise when the senior independent director is a nomination committee member (NCSINED),
- (iii) Proportion of family member directors on the nomination committee (NCFAM),
- (iv) Binary coding of 1 or 0 otherwise when the CEO, CFO or Managing Director is not a nomination committee member (NCEXCEO),
- (v) Binary coding of 1 or 0 otherwise when the nomination committee is chaired by an independent director (NCHINED),

In addition, the following corporate governance variables are included in the research model, namely, the:

- (i) Binary coding of 1 or 0 otherwise when the CEO or Managing Director is not a board member (EXCEO)
- (ii) The proportion of family members on the board (NFAMDI)

Furthermore, the nomination committee attributes model is controlled by:

- (i) Firm size as measured by total assets (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (iii) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV) and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],

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- (iv) Binary coding of 1 or 0 otherwise when the firm's external auditor is one of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUF5],
- (v) Size of board of directors (NBDSZ) and
- (vi) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]<sup>43</sup>.

Accordingly, the following research model **OLS 8** will empirically investigate the impact of nomination committee independence and structure on firm performance,

$$\begin{aligned}
 \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{NCINED} + \beta_1 \text{NCSINED} + \beta_2 \text{NCFAM} + \beta_3 \text{NCEXCEO} + \\
 & \beta_4 \text{NCHINED} + \beta_5 \text{EXCEO} + \beta_6 \text{NFAMDI} + \sum_{k=1}^5 \text{Control Variables} + \\
 & \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j
 \end{aligned}$$

### 5.2.2.2 Remuneration Committee and Firm Performance

The importance of formally establishing a remuneration committee in the firm has been emphasised by the Cadbury Report (1992), Greenbury Report (1995), MCCG (2001) and the Higg Report (2003). Its formation ensures formal and transparent procedures are carried out when evaluating executive performance and remuneration policies. The committee's duties include assessing the contract of employment of senior executives (Carson, 2002). The efficiency of the remuneration committee, namely, its awareness of factors that may have

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<sup>43</sup> See *ibid* 27.

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affected the fair evaluation of executives' compensation is important. According to (Duru et al., 2002), the appropriate adjustment of CEO compensation from income decreasing effect (i.e. value enhancement strategic expenditure) to value increasing activities, such as research and development expenditure, provides an efficient contract between the firm's owners and agents.

Yermack (1997) posited that the lack of proper monitoring and control of executives' compensation scheme may increase executive officers' alliance with the CEO in setting high compensation for executives. In addition, executives have been found receiving higher compensation not matched with higher firm profitability but rather due to inflation, staff redundancy and pay reduction (Greenbury, 1995). Notably, the Cadbury Report (1998), recommended the establishment of an independent remuneration committee and the appointment of a non-executive director as the committee's chairman. Consistently, Vafeas (2000) has argued that the inherent conflict of interest between shareholders and managers justifies the establishment of an independent remuneration committee for better protection of shareholders' investments. Further, Gregory (2001) noted management's tendency to reward themselves excessively.

In consideration of the above arguments, the following research hypotheses relating to the remuneration committee's impact on firm performance are proposed.

HRC 1: The establishment of a remuneration committee in the firm will have a positive impact on firm performance,

HRC 2: The proportion of independent directors on the remuneration committee will have a positive impact on firm performance,

HRC 3: The presence of senior independent directors on the remuneration committee will have an impact on firm performance,



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HRC 4: The presence of family member(s) on the remuneration committee will have an impact on firm performance,

HRC 5: The exclusion of the CEO, CFO or Managing Director from remuneration committee membership will have a positive impact on firm performance,

HRC 6: The chairing of the remuneration committee by an independent director will have a positive impact on firm performance,

HRC 7: The chairing of the remuneration committee by a senior independent director will have an impact on firm performance.

In particular, the explanatory variable for the remuneration committee establishment model is a binary coding of 1 or 0 otherwise when the firm has established the committee (RCEXIST).

Further, this research model investigates the presence of the following corporate governance variables:

- (i) Proportion of independent directors on the board (NINED),
- (ii) Binary coding of 1 or 0 otherwise when there is a senior independent director on the board (SRINED),
- (iii) Binary coding of 1 or 0 otherwise when the CEO or Managing Director is not a board member (EXCEO),
- (iv) Binary coding of 1 or 0 otherwise when independent director chaired the board of directors (CHINED),
- (v) Binary coding of 1 or 0 otherwise when the founder is a board member (FOUD),
- (vi) The proportion of family members on the board (NFAMDI)

In addition, the following control variables will be employed in the remuneration committee existence research model:

- (i) Firm size as measured by total assets (NASET),
- (ii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),

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- (iii) The proportion of specific foreign directors (i.e. from European countries, the USA, Australia, New Zealand and Singapore)⁴⁴ on the board (NFORS),
- (iv) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV) and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],
- (v) Size of board of directors (NBDSZ) and
- (vi) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]⁴⁵.

The testing of HRC 1 regarding the impact of remuneration committee establishment on firm performance is empirically examined by the research model **OLS 9** and is represented as follows:

$$Firm\ Performance_i = \alpha + \beta_0 RCEXIST + \beta_1 NINED + \beta_2 SRINED + \beta_3 EXCEO + \beta_4 CHINED + \beta_5 FOUN + \beta_6 NFAMDI + \sum_{k=1}^6 Control\ Variables + \sum_{m=1}^8 Industry\ Dummy + \epsilon_j$$

With respect to the testing of HRC 2, 3, 4, 5, 6 and 7, the following represent the explanatory variables of the remuneration committee attributes research model:

- (i) Proportion of independent directors on the remuneration committee (RCINED),
- (ii) Binary coding of 1 or 0 otherwise when the senior independent director is a remuneration committee member (RCSINED)
- (iii) Proportion of family member directors on the remuneration committee (RCFAM),

⁴⁴ This represents foreign directors from European countries (i.e. the UK, France, Germany, Denmark and Switzerland), the US, Australia and Singapore in consideration of their corporate governance standard ranking [see Cornelius, 2005: FTSE, 2005].

⁴⁵ See *ibid* 27.

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- (iv) Binary coding of 1 or 0 otherwise when the CEO, CFO or Managing Director is not a remuneration committee member (RCEXCEO),
- (v) Binary coding of 1 or 0 otherwise when the remuneration committee is chaired by an independent director (RCHINED),

The following corporate governance variables are added in the research model:

- (i) Binary coding of 1 or 0 otherwise when the CEO or Managing Director is not a board member (EXCEO)
- (ii) The proportion of family members on the board (NFAMDI)

Respectively, the following control variables are applied in the remuneration committee attributes model:

- (vii) Firm size as measured by total assets (NASET),
- (viii) Leverage as measured by the ratio of Total Debt to Firm Equity (NDEQ),
- (ix) The percentage shareholdings of 5% and more by individuals and/or private companies (NINDPV) and institutional investors (i.e. government institution, public limited companies, unit trust and other private institutions) [NINSTL],
- (x) Binary coding of 1 or 0 otherwise when the firm's external auditor is one of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUF5],
- (xi) Size of board of directors (NBDSZ) and
- (xii) Industry Dummy (INDS) which represents two categories. The first category is a dummy variable of 1 if the company is a Main Board or 0 if otherwise (MAINB). The second category represents the seven industries to which Main and Second Board firms belong, namely, trading and services (TRADG), plantation (PLANT), finance (FIN), construction (CONSTR), consumer products (CONPRO), property (PROP) and miscellaneous (MISCL) [i.e. which includes infrastructure project companies, the hotel industry, and mining]⁴⁶.

⁴⁶ See *ibid* 27.

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Accordingly, the following research model **OLS 10** will empirically investigate the impact of nomination committee independence and structure on firm performance:

$$\begin{aligned} \text{Firm Performance}_{it} = & \alpha + \beta_0 \text{NCINED} + \beta_1 \text{NCSINED} + \beta_2 \text{NCFAM} + \beta_3 \text{NCEXCEO} + \\ & \beta_4 \text{NCHINED} + \beta_5 \text{NCHSINED} + \beta_6 \text{DOINED} + \\ & \sum_{m=1}^8 \text{Industry Dummy} + \varepsilon_j \end{aligned}$$

5.3 Measures of Financial Performance

In measuring a firm's financial performance, numerous researchers have adopted either market-value measures or accounting-based measures or both of these measures. Market-value indicators, such as share price, market capitalisation, Tobin's Q, estimated abnormal returns, and changes and growth, provide the current value of the company's assets. Studying the effect of companies' announcements on the appointment of outside directors, Rosenstein and Wyatt (1990) reported a positive influence on firms' share prices. In their study of the impact of takeovers on firm performance, Cotter et al., (1997) noted shareholders will be compensated highly when firms' boards of directors comprise a majority of shareholders. In addition, the share price of those companies exercising the poison pill option do not plummet when a majority of outside directors are present on the board as their actions are perceived as important in protecting investors' interests (Brickley et al., 1994).

Accounting-based measures of performance, namely, profitability ratios, such as return on investment, return on assets and return on equity, profit margin liquidity ratios, such as acid test ratios and gearing ratios, such as debt to total equity and debt, are historical in value. However, many studies such as Allen and Panian, 1982; Baysinger and Butler, 1985; Rechner and Dalton,

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1991; Tosi, Jr. and Gomez-Meija, 1994; Hutchinson and Gul, 2003; Øxelheim and Randøy, 2003 have employed financial ratios as measures of firm performance in their corporate governance studies

Hermalin and Weisbach (1988) used earning before interest and tax (EBIT) and stock return to measure the impact of board of directors' composition on firm performance. MacAvoy and Millstein (1999) found accounting-based measures of performance to be positively linked to board independence. On the other hand, the use of return on assets and sales as a performance measure to identify the effect of companies' employing a majority of independent directors has not resulted in statistically significant results (Fosberg, 1989). Nevertheless, according to Chakravarthy (1986) these measures are useful in evaluating firms past performance and historical trends.

The use of Tobin's Q as a stock market-based measure of firm-level economic performance is widespread [for instance, Montgomery and Wernerfelt, (1988); Yermack, (1996); Himmelberg et al., (1999); Kapper and Love, (2004); Kor and Mahoney, (2005)]. In particular, the Q ratio explains the extent to which a firm's creation of economic value can be attributed to shareholders' returns. As the value of its numerator variables denotes the market value of the firm, a value of Q more than 1 indicates shareholders' gains with respect to the investment decisions implemented by the firm over the designated financial period. The market value corresponds to market expectations about the future growth and profitability potential of the company (Montgomery and Wernerfelt, 1988).

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Notably accounting-based measures of performance have been criticised for their lack of recognition of differences in firms' systematic risks across different industries (Wernerfelt and Montgomery, 1988). However, Baysinger and Butler (1985) argued that, the use of financial ratios is appropriate because of their proximity to shareholders' returns and their frequent use in cross-sectional analysis. To some extent, accounting-based measures provide a reasonable quantification of shareholders' returns to firms across different industries. Averaging individual firms' financial ratio with the industry ratio normalises any spurious industry effects as well as secular trends and the influence of business cycles (Baysinger and Butler, 1985).

Market based measures such as Tobin's Q provide an estimation of equilibrium return such that it implicitly encapsulates the risk-adjusted discount rate and hence minimises disparity due to tax laws and accounting convention (Wernerfelt and Montgomery, 1988). On the other hand, Dahya and Powell (1998) contend that there are other factors such as industry and economic circumstances that may affect the value of the firm rather than managers' actions.

In addition, according to Chan et al., (2006), the firm's generation of sales further indicates the performance of its business. Shivdasani (1993) has also examined the growth rate of a firm's sales to measure board composition influence on the firm performance. Further Drobetz et al., (2004) examined the impact of corporate governance rating on the firm's earnings, investment and sales growth.

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5.4 Summary of the Research Hypotheses and Models

As detailed in the previous section, there are ten Ordinary Least Square models examined in this research. The following Table 5.1 lists the study’s research models, which examine the impact of the board of directors’ and board subcommittees’ attributes on firm performance, respectively.

Table 5.1: Board of Directors’ and Board Subcommittees’ Ordinary Least Square (OLS) Research Models

<u>OLS Models</u>	<u>Research Focus</u>
<i><u>Board of Director Attributes and Firm Performance</u></i>	
OLS 1	BOD Independence and Firm Performance
OLS 2	BOD Leadership and Firm Performance
OLS 3	BOD Qualifications and Firm Performance
<i><u>Audit Committee Attributes and Firm Performance</u></i>	
OLS 4	AC Independence and Firm Performance
OLS 5	AC Leadership and Firm Performance
OLS 6	AC Qualifications and Firm Performance
<i><u>Nomination Committee Establishment and Attributes and Firm Performance</u></i>	
OLS 7	NC Establishment and Firm Performance
OLS 8	NC Characteristics and Firm Performance
<i><u>Remuneration Committee Establishment and Attributes and Firm Performance</u></i>	
OLS 9	RC Establishment and Firm Performance
OLS 10	RC Characteristics and Firm Performance

(Note: BOD = Board of Directors; AC = Audit Committee; NC = Nomination Committee; RC = Remuneration Committee)

The following Tables 5.1, 5.2 and 5.3 present a summary of the research hypotheses pertaining to the impact of board of directors’ attributes on firm performance, audit committee attributes on firm performance, and nomination and remuneration committees’ attributes on firm performance, respectively.

Table 5.2: Summary of the Research Hypotheses Regarding the Impact of Board of Directors' Attributes on Firm Performance

HYPOTHESES REGARDING THE IMPACT OF BOARD OF DIRECTORS' ATTRIBUTES ON FIRM PERFORMANCE					
<i>Board of Directors' Independence (OLS 1)</i>		<i>Board of Directors' Leadership (OLS 2)</i>		<i>Board of Directors' Competency (OLS 3)</i>	
Hypothesis HBIND	Postulated Relationship (+/-/?)	Hypothesis HBL	Postulated Relationship (+/-/?)	Hypothesis HBKNOW	Postulated Relationship (+/-/?)
HBIND 1: <i>Proportion of INEDs (NINED)</i>	+	HBL 1: <i>Appointment of INED as Board's Chairman (CHINED)</i>	+	HBKNOW 1: <i>BOD Higher Level of Education (i.e. NDEG, NMASK, NPROFL, NPHD)</i>	+
HBIND 2: <i>Domination of INEDs (DOINED)</i>	+	HBL 2: <i>Appointment of SRINED as Board's Chairman (CHSINED)</i>	+	HBKNOW 2: <i>BOD Areas of Expertise (i.e. NACTGK, NFINK, NBUSK, NLAWK, NEXEPROG, NCHASEC)</i>	+
HBIND 3: <i>Domination of INEDs and NEDs (DONEDI)</i>	?	HBL 3: <i>Appointment of FOUN as Board's Chairman (CHFOUN)</i>	?		
HBIND 4: <i>Proportion of INEDs with ACF (INACF)</i>	+	HBL 4: <i>Appointment of NED as Board's Chairman (CHNED)</i>	?		
HBIND 5: <i>Presence of SRINED</i>	?	HBL 5: <i>Appointment of FAMDI as Board's Chairman (CHFAM)</i>	?		
HBIND 6: <i>Exclusion of CEO, CFO, COO and MD (EXCEO)</i>	+	HBL 6: <i>Separate Appointment of CEO and Board's Chairman (SEPCEO)</i>	+		
HBIND 7: <i>Presence of Independent Board Chairman (CHINED)</i>	+				
HBIND 8: <i>Presence of FOUN</i>	?				
HBIND 9 : <i>Proportion of FAMDI (NFAMDI)</i>	?				
HBIND 10: <i>Proportion of INEDs' shares ownership (NINS DG)</i>	+				

Notes: INED = Independent Director; NED = Non Executive Director; ACF = Accounting and Finance Knowledge and Skills; SRINED=Senior INED; CEO = Chief Executive Director; CFO = Chief Financial Officer; COO = Chief Operating Officer; MD = Managing Director; FOUN = Founder; FAMDI =Family-Member Director; BOD = Board of Director; + = positive relationship; - = negative relationship; ? = relationship to be identified

Table 5.3: Summary of the Research Hypotheses Regarding the Impact of Audit Committee’s Attributes on Firm Performance

HYPOTHESES REGARDING THE IMPACT OF AUDIT COMMITTEE’S ATTRIBUTES ON FIRM PERFORMANCE					
Audit Committee’s Independence (OLS 4)		Audit Committee’s Leadership (OLS 5)		Audit Committee’s Competency (OLS 6)	
Hypothesis HACIND INEDs	Postulated Relationship (+/-/?)	Hypothesis HACL	Postulated Relationship (+/-/?)	Hypothesis HACKNOW	Postulated Relationship (+/-/?)
HACIND 1: AC’s composition wholly INEDs (AUDF)	+	HACL 1: Chairing of AC by SRINED (ACHSIN)	+	HACKNOW 1: Proportion of AC members with ACF background (NAUACF)	+
HACIND 2: Domination of INEDs in AC composition (AUGMJ)	+	HACL 2: Chairing of AC by INED with ACF background (ACHACF)	+	HACKNOW 2: Proportion of AC members with PAE (NAPACT)	+
HACIND 3: Majority of INEDs in AC composition (AUDMJ)	+	HACL 3: Chairing of AC by INED with business/management related background (ACHBUS)	?	HACKNOW 3: Proportion of AC members with business/management related background (NACBUS)	?
HACIND 4: Presence of SRINEDs in AC (ACSIN)	+	HACL 4: Chairing of AC by INED with PAE (ACHP)	+	HACKNOW 4: Proportion of AC members with law background (NACLAW)	?
HACIND 5: Presence of at least one independent AC member with PAE (ACPI)	+	HACL 5: Chairing of AC by SRINED with PAE (ACHSINP)	+	HACKNOW 5: Proportion of AC members with company secretary experience (NACSEC)	?
HACIND 6: Presence of at least one AC’s members with PAE (ACPACT)	+				
HACIND 7: Presence of AC’s Chairman with PAE (APACH)	+				
HACIND 8: Exclusion of CEO, CFO and MD from AC (AXCEO)	+				
HACIND 9: Presence of FAMDI in AC (ACFAM)	?				
HACIND 10: AC’s Independent Director Conduct a meeting with auditors without management presence (MTEXT)	+				
HACIND 11: Transparency of AC Authority to Report to Exchange of Firm Violation of Regulations (RBRE)	?				

AC = Audit Committee; INED = Independent Director; PAE = Practising Accountant Experience; SRINED = Senior Independent Director; CEO = Chief Executive Director; CFO = Chief Financial Officer; COO = Chief Operating Officer; MD = Managing Director; FAMDI = Family-Member Director; + = positive relationship; - = negative relationship; ? = relationship to be identified

Table 5.4: Summary of the Research Hypotheses Regarding the Impact of Nomination and Remuneration Committees' Attributes on Firm Performance

HYPOTHESES REGARDING THE IMPACT OF NOMINATION COMMITTEE'S ESTABLISHMENT ON FIRM PERFORMANCE		HYPOTHESES REGARDING THE IMPACT OF REMUNERATION COMMITTEE'S ESTABLISHMENT ON FIRM PERFORMANCE	
Hypothesis HNC (OLS 7)	Postulated Relationship (+/-/?)	Hypothesis HRC (OLS 9)	Postulated Relationship (+/-/?)
HNC 1: <i>The establishment of nomination committee in the firm (NCEXIST)</i>	+	HRC 1: <i>The establishment of remuneration committee in the firm (RCEXIST)</i>	+
HYPOTHESES OF THE IMPACT OF NOMINATION COMMITTEE'S ATTRIBUTES ON FIRM PERFORMANCE		HYPOTHESES OF THE IMPACT OF REMUNERATION COMMITTEE'S ATTRIBUTES ON FIRM PERFORMANCE	
Hypothesis HNC (OLS 8)	Postulated Relationship (+/-/?)	Hypothesis HRC (OLS 10)	Postulated Relationship (+/-/?)
HNC 2: <i>The proportion of INEDs on NC (NCINED)</i>	+	HRC 2: <i>The proportion of INEDs on RC (RCINED)</i>	+
HNC 3: <i>The presence of SRINEDs on NC (NCSINED)</i>	?	HRC 3: <i>The presence of SRINEDs on RC (RCSINED)</i>	+
HNC 4: <i>The presence of FAMDI on NC (NCFAM)</i>	?	HRC 4: <i>The presence of FAMDI on RC (RCFAM)</i>	?
HNC 5: <i>The exclusion of CEO, CFO and MD from NC membership (NCEXCEO)</i>	+	HRC 5: <i>The exclusion of CEO, CFO and MD from RC membership (RCEXCEO)</i>	+
HNC 6: <i>The chairing of NC by a INED (NCHINED)</i>	+	HRC 6: <i>The chairing of RC by a INED (RCHINED)</i>	+
HNC 7: <i>The chairing of NC by a SRINED (NCHSINED)</i>	+	HRC 7: <i>The chairing of RC by a SRINED (RCHSINED)</i>	+

INED = Independent Director; NC = Nomination Committee; RC = Remuneration Committee; SRINED = Senior Independent Director; FAMDI = Family-Member Director; CEO = Chief Executive Director; CFO = Chief Financial Officer; MD = Managing Director; + = positive relationship; - = negative relationship; ? = relationship to be identified

5.5 Conclusion

Chapter 5 has described the development of research hypotheses and models to examine the impact of board of directors' and board subcommittees' attributes on firm performance. As presented in Table 5.1 above, ten research questions have been developed to study the corporate governance practices of Malaysian firms. In addition the chapter also provides reviews on the types of firm performance measures used by researchers when examining the impact of firm corporate governance practices on firm performance. The next chapter will elaborate further upon the source of the data of the research models.

Chapter 6

~Research Design and Methodology~

6.0 Introduction

The purpose of this chapter is to explain and justify the methodology adopted in this research to support the validity and reliability of its findings. The research hypotheses were tested using secondary data published in the 2002 and 2003 annual reports of Main Board and Second Board companies of Malaysia Bourse⁴⁷. From annual reports, information was extracted relating to firms' board of directors' personal details and activities, board's sub-committees' related information, other relevant corporate governance information, other accounting data and firm's shares ownership. Financial data relating to firms' performance (namely earnings, market value, share price, sales and financial ratio), capital structure and size (i.e. shareholders' equity, total debts ratio, assets) and other accounting data were obtained from the Datastream and OSIRIS database to ensure consistency of figures. The chapter also discusses the computation, descriptive statistics and data screening of the dependent, independent and control variables of the research models. The chapter proceeds with the discussion of the research data analysis technique, multiple regression analysis, in relation to their assumptions and implementation for hypothesis testing.

6.1 Cross-Sectional Research Approach

The study adopted a cross-sectional research approach to examine the relationship between corporate governance variables and firm value. Furthermore, the research approach was considered appropriate to be implemented on a reasonably detailed examination of the impact of

⁴⁷ At the time the data was collected the Stock Exchange name was Kuala Lumpur Stock Exchange (KLSE)

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firms' implementation of Principles and Best Practices of the Malaysian Code of Corporate Governance (MCCG) 2001 and correspondingly MBSB Listing Rulings 2001 on corporate governance. In particular, the current study concentrates on MCCG and MBSB corporate governance listing requirements pertaining to board of directors' and board subcommittees' corporate governance practice. Prior to the enactment of the Revamped Listing Rulings in January, 2001, information about boards of directors' members, such as their age, relationship with family members, independence status and educational background, was not publicly disclosed in the company pro-forma report.

Moreover, due to the relatively recent introduction of the MCCG 2001 and MBSB Listing Rulings 2001, listed companies have been in an 'adjustment period' in their adoption of the additional corporate governance disclosure and transparency requirements. Further, listed companies are allowed to use their discretion in deciding the format and contents of their disclosure to comply with Parts I and II of the Principles of Corporate Governance and Best Practices (Task Force on Internal Control, 2000: Para 8). Hence, it was considered useful to examine empirically their perspectives on the importance of and the extent of their commitment to complying with and enforcing the Principles of the Code of Corporate Governance and Code of Best Practices.

The current research has not used questionnaires surveys and interviews as part of its data collection method since it was felt that the deployment of the secondary data would be appropriate (see also section 6.4) and sufficient to provide systematic and extensive empirical examination to fulfil the designated research questions and objectives of the study as identified

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in Chapter 1 (Section 1.2 and 1.3) on the impact of board of directors' and board committees' attributes on firm performance. In addition, the current research models (see research models in Chapter 5) distinctively accounted for the direct impact of board committees' attributes on firm performance (see Chapter 5, section 5.2). Furthermore, recent studies on corporate governance practice of Malaysian listed companies by KLSE and PwC (2002) and PwC (2005) had been comprehensively conducted using questionnaires survey. Moreover, the designated empirical study research approach accommodate investigation of Malaysian firms corporate governance practices for more than one year period and prospectively more companies can be researched as required data is gathered by the researcher rather than depending on companies responses of the questionnaires survey⁴⁸. Respectively, the sample size of firms in this study represents almost 50% of designated population of listed firms in Kuala Lumpur Stock Exchange (see further Section 6.3.1).

To date, the empirical studies conducted by Abdullah (2004) and Chang Aik Leng and Abu Mansor (2005) on the link between Malaysian listed firms' corporate governance practice and their firm performance have examined the set-up in year 2001 and earlier. Much more, the corporate governance surveys undertaken by KLSE and PwC (2002) and PwC (2004) gathered wide-ranging corporate governance information notably encompassing the responses of members of Board of Directors, public listed companies, independent directors and institutional groups) on Malaysian listed firms corporate governance practice in general and in particular their implementation of MCCG (2001). Given the significance of continuous study on this subject, it was felt appropriate to utilise the respective information gathered by KLSE and PwCs' surveys (amongst others) by undertaking empirical study that extends the period of

⁴⁸ KLSE and PwC (2002:15) reported the average level of postal survey response rate for Malaysia is 15%.

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observation of previous studies and hence providing ongoing evidence on the impact of Malaysian firms internal corporate governance practices on firm performance. Furthermore, the designation of the current study will hopefully assist in fulfilling the aim of the Malaysia Securities Commission and Malaysia Bourse of Securities Limited to ensure commitment amongst listed companies in Malaysia to enhance their corporate governance conduct responsibly.

6.2 Data Description

As mentioned earlier, the research examined the relationship between the internal governance of Main Board and Second Board companies in the MBSB⁴⁹ and firm performance. The two boards are differentiated by their minimum required paid-up capital. Specifically, Main Board companies are those firms with a minimum paid up capital of Malaysian Ringgit (RM) 60 million (or USD16.82 million)⁵⁰ of RM1.00 ordinary shares, whilst Second Board firms' minimum paid up capital is RM 40 million (or USD11.21 million)⁵¹ of RM1.00 ordinary shares (see paragraph 3.04, Chapter 3 of MBSB Listing Requirements 2001).

Specifically, the research focused on listed companies' board of directors' and board subcommittees' governance practices as recommended by the Malaysian Code of Corporate Governance (see MICG, 2001) and MBSB Listing Requirements 2001. The latter's corporate governance requirements were first adopted by listed companies with June 2001 or later months financial year end. The aforementioned requirements require companies to implement the

⁴⁹ Starting from 20th of April 2004 KLSE became a de-mutualised exchange and changed its name to Malaysia Bourse Securities Limited [See: MBSB, 2004(ii)].

⁵⁰ Based on the Central Bank of Malaysia currency exchange rate as at 17th of May 2006 (see, Central Bank of Malaysia, 2006)

⁵¹ See Ibid 2.

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principles of the Malaysian Code of Corporate Governance and demonstrate the extent of their compliance with and reasons for non-compliance with the Best Practices Code of Corporate Governance 2001 in their 2001 statutory annual pro-forma reports (Bursa Malaysia Securities Berhad, 2001 (a), (b); Kulasingham, 2003).

In light of the recommendations of the Code of Corporate Governance and MBSB Listing Rulings 2001, the research was specifically structured to observe the impact on firm performance of the adoption of governance practices in the period between 2002 and 2003.

The selection of the chosen period of observation was motivated by the following factors:

(1) The period of observation was chosen to facilitate the extraction of narrative and financial information from the annual reports of firms with earlier than June 2001 financial year end.

(2) Further, as studies by Lawrence and Lorsch (1967); Pfeffer (1972); La Porta et al., (1999) and Shleifer and Vishny (2002) have shown, external demands, such as regulatory requirements, can force an organisation to reform its internal structure, which would include extending its disclosure contents. This validated the designated period of observation and minimised the possibility of data being incomplete.

(3) Extending the period of observation to two years instead of one led to a better understanding of the progress of firms' corporate governance practice and disclosure and transparency initiatives in later years.

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(4) The observation period also allowed assessment of the Stock Exchange Rulings' time lag effects. Studies by Baysinger and Butler, 1985; Donaldson and Davis, 1991; Bhagat and Black, 2001; Anderson and Reeb, 2003; Hermalin and Weisbach, 2003, have indicated that the impact of firm implementation of corporate governance may be better captured by the firm's subsequent year performance.

6.3 Sampling Procedures

Researchers undertake population sampling for various reasons; one reason is to facilitate the interpretation of the research results by choosing a reasonably large number of items to be assessed, thus allowing the researcher to be more focused on his/her research parameters (Stuart, 1968). Moreover, the data in a population can number thousands of elements and it would be practically impossible to examine and test the data for the whole population (Henry, 1990; Sekaran, 2003). In addition, other factors, such as cost, time and human resource constraints may further restrict the possibility of using the entire population for the collection of data (Hakim, 2000; Bryman and Cramer, 2002). Further, the likelihood of making errors in data collection is reduced when a sample rather than an entire population is observed, given the smaller number of elements examined (Sekaran, 2003). Consequently, samples provide a practical and efficient means to collect information relevant to a researcher's studies (see Stuart, 1968; Henry, 1990; De Vaus, 2002).

There are two types of sampling techniques: probability and non-probability sampling. Probability sampling is based on the assumption that every element in the population has a specifiable probability of being selected as a sample subject (Henry, 1990; Black, 1999). It is

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suitable when the purpose of the sampling is to represent the generalisability of the population's traits (Sekaran, 2003:270). In contrast, the non-probability sampling technique chooses a sample of elements from a population without assigning a known or pre-determined probability for the elements in the population to be selected (Black, 1999). Specifically, the elements in the population are selected based on systematically employed data, convenience, and/or subjective judgement (Henry, 1990).

6.3.1 *Sample Size*

It is imperative to justify the underlying principle for selecting a particular sample size because the sample is rarely the exact replica of the population from which it is taken. This is necessary to ensure the reliability and representativeness of the sample of the population under review (Nachmias, 1996). According to Black (1999), a sample size can be determined by identifying the fraction of the population to be sampled, taking into account the level of error to be tolerated between the sample and the population estimators. The selection of a large sample is, however, required to obtain 'accurate' statistical result (Saunders et al., 1997). Nevertheless, Fowler (1993) contends that, as long as the sample size is more than 10% of the population size, the fraction of the population sampled has less impact on the standard error of the mean than it would were the sample size less than 10%. Moreover, as the sample size (n) increases, the mean of the sample obtained from the population approaches a normal distribution with mean (μ) and standard deviation of $\frac{\sigma}{\sqrt{n}}$ [see Hair et al., 1998]. As a result, regardless of whether or not the attributes of the population are normally distributed, if the size of the sample taken is sufficiently large, a normal sampling distribution will be obtained.

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Table 6.1: Sample Size for a given Population Size

N (Population Size)	S (Estimated Sample Size)	N (Population Size)	S (Estimated Sample Size)	N (Population Size)	S (Estimated Sample Size)
10	10	220	140	1200	291
15	14	230	144	1300	297
20	19	240	148	1400	302
25	24	250	152	1500	306
30	28	260	155	1600	310
35	32	270	159	1700	313
40	36	280	162	1800	317
45	40	290	165	1900	320
50	44	300	169	2000	322
55	48	320	175	2200	327
60	52	340	181	2400	331
65	56	360	186	2600	335
70	59	380	191	2800	338
75	63	400	196	3000	341
80	66	420	201	3500	346
85	70	440	205	4000	351
90	73	460	210	4500	354
95	76	480	214	5000	357
100	80	500	217	6000	361
110	86	550	226	7000	364
120	92	600	234	8000	367
130	97	650	242	9000	368
140	103	700	248	10000	370
150	108	750	254	15000	375
160	113	800	260	20000	377
170	118	850	265	30000	379
180	123	900	269	40000	380
190	127	950	274	50000	381
200	132	1000	278	75000	382
210	136	1100	285	1000000	384

[Source: Adopted from Sekaran (2003:294)]

Based on the work of Krejcie and Morgan (1970) for determining the sample size of a research population, Sekaran (2003:294) provides tabulated figures of sample size for a given population size (see Table 6.1). In Table 6.1, the *N* column represents population size, whilst the *S* column denotes estimated sample size. Where the population size falls in the range of certain values, an extrapolation technique is used to determine the sample size. Thus, for the present research on corporate governance, given that the identified population size is 486 firms (see further section

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6.3.3), this places the sample size between 214 (for a population size of 480) and 217 (for a population size of 500). Hence, the extrapolated sample size for a population of 486 firms is:

$$\left[\frac{(486 - 480)}{(500 - 480)} \times (217 - 214) \right] + 214 = 214.9 \approx 215 \text{ firms.}$$

Moreover, Roscoe (1975) suggests several rules of thumb for sample size designation as below:

1. Sample sizes that are larger than 30 and less than 500 are suitable for most research.
2. Where samples are to be broken into sub-samples, (male/female, junior/senior, etc.), a minimum sample size of 30 for each category is necessary.
3. In multivariate research (including multiple regression analyses), the sample size should be several times (preferably 10 times or more) as large as the number of variables in the study.
4. For simple experimental research with tight experimental controls (matched pairs, etc.), successful research is possible with samples as small as 10 to 20 in size.

[Source: Sekaran (2003:295)]

According to Field (2005:172), it is important to obtain a large sample size (N) given the number of predictors (k) employed in regression models, since the latter will have an effect on the estimate of R, that is, the multiple correlation coefficient, produced by the regression models. Hence, in deciding the sample size, he suggests using the expected R formula for random data, that is, $\frac{k}{N-1}$, where *k* is the number of predictors to be used in the regression model and N is the projected sample size. The best expected R value for random data would be 0, which indicates no effect, and achieving this requires a large N size (Field, 2005:172).

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Further, the types of test that a researcher plans to undertake, whether to examine the overall fitness of the regression model or the individual predictors of the model, will also determine the sample size (Green, 1991; and Tabachnick and Fidell, 2001). Green (1991) proposed a formula for a minimum sample size of $50 + 80k^{52}$ for the first type of research objective and a formula of $104 + k$ to obtain an acceptable size of sample for the latter type of research objective.

After considering various options for sample size determination, following the sample size guide in Sekaran (2003: 294) it was found that the sample reasonably fulfilled the recommended minimum sample size proposed by other researchers.

6.3.2 *Types of Probability Sampling Techniques*

Probability sampling involves the selection of sample items based on a random selection process. It is a technique that facilitates the independent selection of each unit in the sample to avoid subjective bias in the selection process and to ensure a sample that is representative of population traits (Henry, 1990: 26). Methods of probability sampling include simple random sampling, systematic sampling, and stratified sampling.

Simple random sampling is a process where each item in a population has an equal chance of being selected as part of the sample. It is carried out using a table or statistical software package, such as Microsoft Excel and SPSS, to generate random numbers to select individual samples from the population. Simple random sampling suits the type of research that aims to generalise the research findings to the whole population (Sekaran, 2003). It also minimises bias and offers

⁵² k is the number of predictors or independent variables used in the regression models.

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better generalisability of population than other methods (Black, 1999; Sekaran, 2003). In contrast, random sampling can produce an extreme sample given the variations that may be embedded in the potential sample's subject mix (Stuart, 1968).

However, according to the Central Limit Theorem, as long as the sample size is large it makes no difference what form of distribution the sample has, whether there are many low and few high values or vice versa, because the sample average will closely approximate to the normal distribution. Also, every sample has a unique feature and as long as the right sample selection technique is applied, the sample size chosen will be acceptable (Sekaran, 2003: 268).

Systematic sampling, on the other hand, draws a sample from items in the population that are within a certain interval. For instance, given a list of n size of population, a sample's items are selected for every i th element in the population. Another sampling technique is stratified random sampling. This involves the stratification or segregation of subjects from the population by dividing the population into mutually exclusive groups or strata (Sekaran, 2003). Subjects are then randomly selected from each stratum to form the sample. Proportionate stratified random sampling selects subjects from each stratum to make up the sample size identified. On the other hand, disproportionate stratified random sampling takes place when large variability is suspected in a stratum or there is a large difference in stratum size.

Given the above characteristics of different sampling techniques, the simple random sampling technique was chosen as the sampling method for selecting Main Board and Second Board firms

in the Kuala Lumpur Stock Exchange because it provides better representation of the population and less bias than other techniques.

6.3.3 Sampling of Main Board and Second Board Companies in the KLSE

The sampling of Main Board and Second Board firms in the MBSB commenced with a perusal of its Main and Second Board’s list of firms. Firm population was determined from the index of firms in each Board published in the *Investors’ Digest*⁵³ January 2000 and 2004. Specifically, public listed companies chosen for sampling were Main and Second Board companies that had remained in the same Board from the beginning of the year 1999 until end of 2003. Table 6.2 shows the year when the sampled companies were formed (i.e. the Main Board and Second Board sampled firms in Table 6.5). As the listing period was extended to the early years of the new millennium, this presented the opportunity to evaluate firms’ visibility, prestige and, in due course, their future prospects, notably their liquidity and marketability (Baker et al., 1999).

Table 6.2: Number of Sampled Companies Formed Between the 1970s to 1990s

Year of Formation	Number of Companies
1970s	1
1980s	77
1990s	143
Earliest (Year): 1973; Latest (Year): 1999; Mode (Year): 1986	

It is worth noting that Malaysia had substantially recovered from the economic crisis in the mid 1990s by the second-half of 1999 (MEPU, 2001). Making an allowance for this circumstance,

⁵³ The *Investors’ Digest* was a Kuala Lumpur Stock Exchange monthly publication. See pages 55 to 59 and pages 56 to 60 of the January 2000 and 2004 issues, respectively.

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the observed sample firms were classified into firms that had existed before the crisis and survived it, and firms that were founded after the crisis, thus providing unique informational elements to the research. By and large, firms' continued listing in the Stock Exchange indicated a history of continued economic value in the present and future, and particularly effective survival and adaptation strategies in the form of efficient learning and absorption of knowledge (Kor and Mahoney, 2005). The presence of firms with transitory periods of listing pointed to their tendency to attain shorter performance goals as a result of changes in their unique and specialist resources (Mosakowski, 1993).

The first step of the firms' sampling procedure was to obtain the names of Main and Second Board companies from the *Investors' Digest* January 2000 and 2004 (see Tables 6.3 and 6.4 for Main and Second Board companies according to their sector grouping for the years 2000 and 2004, respectively). A list of companies that had been in operation from 1999 until 2003 was ultimately established. The list was then cross-referenced with the full list of Malaysian listed companies⁵⁴ in the Datastream database to obtain companies' full names, since company names had been abbreviated in the *Investors' Digest*. In addition, the Kuala Lumpur Stock Exchange (KLSE) was contacted to obtain the full version of the abbreviated names, since companies' full names were required to identify and download their corresponding annual reports from the Kuala Lumpur Stock Exchange's website⁵⁵. Eventually, a list of all 486 Main and Second Board companies was compiled by matching the updated companies' list in the financial year ending 1999 with the updated companies' list in the financial year ending 2004 (see Table 6.5: Population of Firms).

⁵⁴ The data series code for the full list of the Malaysian listed companies in the Datastream database was FMAQ1.

⁵⁵ See Bursa Malaysia Company Announcements at <http://announcements.bursamalaysia.com/linkwebmainpage.nsf/lca.htm>, 2005.

Table 6.3: Main Board & Second Board Firms and Industries (January 2000)

Main Board Firms			
Sectors	Number of Companies	Listed Nominal Amount (RM'000)	Listed Market Valuation(RM'000)
Consumer Products	56	7,837,878	42,724,161
Industrial Products	107	20,338,507	68,667,580
Construction	32	7,267,703	31,351,756
Trading/Services	66	31,971,037	185,047,816
Finance	62	25,100,710	109,871,653
Hotels	6	1,750,290	1,795,204
Properties	72	16,235,524	29,343,725
Plantations	37	7,308,380	25,234,857
Mining	8	737,456	2,653,837
Trusts	4	485,276	378,887
Closed-End Funds	1	500,000	340,000
Infrastructure Project Companies	4	3,819,646	13,841,672
Total	474	123,352,407	511,251,148
Second Board Firms			
Sectors	Number of Companies	Listed Nominal Amount(RM'000)	Listed Market Valuation (RM'000)
Consumer Products	58	1,720,123	4,577,067
Industrial Products	132	4,260,383	11,180,818
Construction	35	1,400,096	2,775,732
Trading/Services	58	1,875,793	6,056,184
Total	283	9,256,395	24,589,801

Source: Investors' Digest Mid-January (2000:86)

Table 6.4: Main Board & Second Board Firms and Industries (January 2004)

Main Board Firms			
Sectors	Number of Companies	Listed Nominal Amount (RM'000)	Listed Market Valuation (RM'000)
Consumer Products	73	10,308,864	55,900,364
Industrial Products	123	22,595,185	57,424,388
Construction	41	9,973,140	27,239,749
Trading/Services	116	45,860,808	229,554,351
Technology	15	1,462,186	9,523,934
Finance	51	35,595,969	124,770,176
Hotels	5	1,430,913	1,269,769
Properties	88	24,698,356	34,610,091
Plantations	39	8,198,027	35,302,289
Mining	2	282,943	830,483
Trusts	3	374,128	238,342
Closed-End Funds	1	500,001	355,001
PN4 Condition	33	7,190,323	2,425,592
Infrastructure Project Companies	8	7,152,040	17,219,643
Total	598	175,622,883	596,664,172
Second Board Firms			
Sectors	Number of Companies	Listed Nominal Amount (RM'000)	Listed Market Valuation(RM'000)
Consumer Products	50	2,271,842	3,348,193
Industrial Products	126	6,766,237	11,408,149
Construction	15	925,200	1,481,848
Trading/Services	49	3,250,413	6,014,265
Technology	5	376,707	633,527
Properties	2	94,978	87,801
Plantations	4	623,674	970,121
PN4 Condition	26	1,298,007	325,982
Total	277	15,607,058	24,269,886

Source: Investors' Digest Mid-January (2004: 62)

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**Table 6.5: The Main Board and Second Board Companies in Operation
Between 1999 to 2004**

Main Board Firms	Population of Firms	Sampled Firms
Sectors	No. of Co.	No. of Co
Trading/Services	66	32
Finance	40	19
Consumer Products	37	21
Industrial Products	73	34
Construction	21	9
Properties	56	24
Plantations	31	17
Hotels	4	2
Infrastructure Project Companies	4	2
Mining	2	0
Trusts	2	-
Closed-End Funds	1	-
Total	337	160
Second Board Firms	Population of Firms	Sampled Firms
Sectors	No. of Co.	No. of Co
Trading/Services	29	9
Consumer Products	28	11
Industrial Products	78	33
Construction	14	8
Total	149	61

Note: For the research purposes, Hotel, Mining and Infrastructure Project Companies were categorised as miscellaneous industry; Trust Funds and Closed End Funds companies were excluded from the sample because they were not required to produce a corporate governance statement)

A sample of 221 companies was subsequently created from the 486 Main Board and Second Board companies using the simple random sampling technique (see Table 6.5: Sampled Firms). The sample size was determined based on sample size guidelines in Sekaran (2003:294) and use of the extrapolation technique discussed in Section 6.3.1 above. Saunders et al., (1997:132) recommend a sample size for research that uses the simple random sampling technique of slightly more than a few hundred subjects. Applying this recommendation, a sample size of 221 meant that almost 50% of the 486 listed firms were studied. The sample size of 221 also broadly

represented⁵⁶ 29% and 25% of the total number of listed companies in the Stock Exchange in 2000 and 2003 respectively.

6.4 Data Sources

The use of documentary, administrative and archival sources has been found to be popular among historians, anthropologists and linguists (Dale et al., 1988). It should be noted that organisational documents vary, ranging from company annual reports, public relations material and press releases, accounts statements, and policies on rules and procedures (Forster, 1997). As regards to their usage in corporate governance studies, Baysinger and Butler (1985) accessed them to collect board biographies for their study of the impact of board composition on firm performance. Technology-based firms' prospectuses have been examined by Kor and Mahoney (2003) to identify the process and timing of new product development revenue generation.

The **advantages** of organisational documents include the following:

- (i) They provide rich insights into organisational life
- (ii) To some extent, the data and information produced by an organisation are comprehensive, especially if they are to be compared with the quality of data that a new researcher can gather from interviews and/or questionnaires
- (iii) Information gathered from the organisation in publicly available documents allows the researcher to examine closely, for instance, the historical process and developments in the organisation in comparison to its current records on related matters.

⁵⁶ Leech and Leahy (1991:1421), justified their sample size by emphasising that their 325 of 470 sampled companies broadly represented the 1000 companies in the UK Stock Exchange at that time.

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- (iv) It is time saving to collect data from a company's documents in comparison to other means.
- (v) The researcher can avoid unnecessary processes of data collection, such as having to contact key personnel or a company secretary who is normally busy.
- (vi) The company document is a good source of information to start with in undertaking preliminary quantitative analysis. *(Source: Forster, 1997)*

However, company documentation may be fragmentary and subjective (Forster, 1997). For instance, it may not record accurately the process of events occurring within the firm's specific period of operation and in detail. Nevertheless, with the exercise of caution regarding the interpretation of company documents, relevant information can be extracted from them (Hakim, 1982).

In this research, companies' annual reports were referred to frequently to gather information on various board aspects, including:

- (i) **Composition:** the number of independent non-executive directors (INED), executive directors (ED), and non executive directors (NED),
- (ii) **Characteristics:** Directorships in other public companies and private companies, educational background, for instance, an accounting and non-accounting background,

Table 6.6: Data Sources

Category	Sources	Related Information
List of Companies	<i>Investors' Digest</i> Mid-January 2000 and 2004 Datastream Database	List of Main Board and Second Board companies as at 30 December 1999 and 31 December 2003, and their corresponding sectors FMAQ1: List of all Malaysian Securities
Board of Director Data	Annual Reports 2002 and 2003	Director's name, age, type of director, appointment date, educational background, family relationship, chairman of board of director, director's share ownership, occupation, ethnic, foreign director, founder, board committees' related information, board activities, other related corporate governance information
External Auditor	Annual Reports 2002 and 2003	Name of audit company
Other Accounting Data	Annual Report 2002 and 2003	Non-Executive Director Remuneration, Non-Audit Fees, Substantial Shareholdings,
Financial Data	Datastream Database	Number of shares, market value, earnings per share, share price, return on investment, return on equity, total asset and net profit

Table 6.7: Sections and/Reports in Annual Report and Information

Section/ Reports	Information Collected
Company Information	Name of Board of Director member, position in the firm, type of director, board of director's chairman, board committees' formation, name of firm's external auditor, board size, director ethnic group.
Directors' Profiles	Age, appointment date, director type (executive, non-executive or independent director), outside directorship (public and/or listed, and/or private companies), educational background, occupation, nominee directors, family relationship, founder and foreigners.
Corporate Governance Statement	Board of Directors' activities (i.e. meetings and attendance), Nomination and Remuneration Committee members, composition, structure, activities and terms of reference and frequency of meetings held and members', Senior independent director information, non-audit fee and non-executive director remuneration.
Audit Committee's Report	Members, composition, terms of reference and activities
Directors' Report	Board of directors' shareholding in the company
Notes to Financial Statement	Non audit fee, non-executive director remuneration
Analysis of Shareholdings	Substantial shareholder's groups and equity holdings

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- (iii) **Structure:** whether there was a separate appointment for the Chairman of the BOD and the firm's Chief Executive Officer (SEPCEO), whether the Chairman of the BOD was an independent director (INED), executive director (ED) or non-executive director (NED); details of board subcommittees, including the audit committee's composition, the frequency of and attendance at meetings (ACMET4, AMETG4 and ATEND), a particular audit committee's responsibilities, and the formation, composition structure and functions of the nomination and remuneration committees (NCEXIST, RCEXIST),
- (iv) **Process:** frequency of and attendance at board of director meetings (BATEND), meetings' agenda, access to and availability of documents, firms' employees, and external independent advice.

The Datastream database was used to obtain companies' financial data, such as their profits, financial ratio, share prices, assets, liabilities and number of shares issued (Ssee Table 6.6 and Table 6.7).

6.5 The Descriptions and Characteristics of Research Models' Parameters

In this section, the computation and characteristics of the research models' variables (see Chapter 5), namely, dependent variables (i.e. firm performance variables), explanatory variables (i.e. respective board of director and its committee attributes) and control variables are explained. The following subsections discuss each category of variables respectively.

6.5.1 *Dependent Variables: Firm Performance Measures*

As discussed in Chapter 4, the firm value can be measured in terms of market value or the accounting-based measure of performance. According to Chakravarthy (1986) and Daily and Dalton (1993), when measuring firm performance, it is worth noting that there is a limitation on the ability of a particular measure of firm performance to capture all aspects of firm accomplishment. The organisation's competitive advantage, the effectiveness of its management system and approach or implementation of certain strategic policies are some of the factors that have influenced the measures of firm performance (Vancil, 1972; Bourgeois III, 1985; Murray, 1995). Further, as Cochran and Wood (1984) point out, there is no consensus regarding the choice of particular measures of firm performance when evaluating the relationship between firm value and corporate governance characteristics. They indicate that the choice of firm performance measures remains wide and ranges from accounting to market values.

For the current research purposes, seven measures of firm performance were identified which encompassed three market value measures and four accounting-based measures of firm performance. The market value measures of firm performance were Tobin's Q, market to book value of equity (MBE) and market to book value of asset (MBA). The use of Tobin's Q as a market value measure of firm performance in corporate governance studies has been widespread, namely, in the study of Himmelberg et al., (1999), Klapper and Love (2004), Drobetz (2004) and Black et al., (2006). In studies by Agrawal and Knoeber (1996), Loughran and Ritter (1997), Core et al., (1999), Dittmar et al., (2003) and Eng and Mak (2003), market to book value of equity and assets has been utilised as measure of firm performance.

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Using the accounting-based measure of firm performance, the current research examined the firm's return on assets (ROA), return on equity (ROE), return on investment (ROI) and earnings to price ratio (EARP). Financial ratios as measures of firm performance in corporate governance studies have been employed by Allen and Panian (1982), Baysinger and Butler (1985), Tosi, Jr. and Gomez-Meija (1994), Yermack (1996), Bushee and Noe (2000), Rechner and Dalton (1991), Hutchinson and Gul (2003), Øxelheim and Randøy (2003), Drobetz et al., (2004) and Chang Aik Leng and Abu Mansor (2005).

6.5.1.1 *Computation of Market Value Measures of Firm Performance*

For the purpose of the current research, **Tobin's Q** was computed in reference to the definition offered by Himmelberg et al., (1999), which is as follows:

$$Tobin's\ Q = \frac{\text{Value of the Firm}}{\text{Replacement Value of Assets}}$$

Specifically, Himmelberg et al., (1999) defined the Value of the Firm as the summation of market value of common equity, Book Value of Total Liabilities, and Estimated Market Value of Preferred Stocks. For most firms in the sample, their preferred dividends payments were nil. Accordingly, the computations of Tobin's Q for a firm's market value were reduced to two estimates, namely, Market Value of Equity (MVE) and Book Value of Total Liabilities, consistent with Kor and Mahoney's (2005) approximation. They also measured the market value of common equity as the multiplication of a firm's closing share price and number of ordinary shares at year end. On the other hand, they described total liabilities as the summation of long-term and short-term debts. For the denominator of Tobin's Q, they approximated the

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replacement value of assets as book value of total assets. The financial data for Tobin's Q computation, namely, the closing share price, number of ordinary shares, long-term debts, short-term debts and total assets were obtained from the Datastream database. In particular the data respectively represented the closing share price (P), number of shares in issue at year end (NOSH), long term debt (wc03251), total current liabilities (wc03101), and total assets (02999AQ) in the Datastream.

The second measure of market value of firm performance, **Market Book Value of Equity (MBE)** was computed as the ratio of market value of equity and common equity

[$\frac{\text{Market Value of Equity}}{\text{Common Equity}}$]. The closing share price (P), number of ordinary shares in issue (NOSH)

and common equity (wc03501) were utilised in the computation. On the other hand, **Market Book Value of Asset (MBA)** was calculated as the ratio of market book value of equity and

total assets ($\frac{\text{Market Value of Equity}}{\text{Total Assets}}$). Similarly closing share price (P), number of ordinary shares

in issue (NOSH) and total asset (02999AQ) in the Datastream were applied in the MBA formulae.

6.5.1.2 *Computation of Accounting-Based Measures of Firm Performance*

For the calculation of the financial ratios of Return on Equity (ROE), Return on Assets (ROA) and Return on Investment (ROI), items used from the Datastream were Net Income before Extraordinary Items/Preferred Dividends or Earned for Ordinary (01551 and 625 respectively), common equity (wc03501), total assets (02999AQ) and total capital employed (322 or 03998)

were used. Whilst for the calculation of Earnings to Price ratio (EARP), items used from the Datastream were Earnings Per Share (18193) and closing share price (P).

6.5.1.3 *Data Characteristics and Factor Analysis of Firm Performance Measures*

Table 6.8 presents the descriptive statistics of the firm performance variables. Due to high skewness and kurtosis level, the data are subsequently transformed to normal scores using Van der Waerden approach (see Cooke, 1998). As shown in Table 6.9, the normal scores transformation reduced the skewness and kurtosis levels of the performance variables to a value near to zero. Also, the transformation improved the normality of the firm performance variables. The normal scores values of the firm performance variables were subsequently implemented in the designated research models (see Chapter 5). Table 6.10 presents the correlation analysis of the seven performance measures. The market value measures and accounting-based measures of firm performance had high correlation amongst them.

In addition, following Hutchinson and Gul (2004), factor analysis was carried out to identify the principal factor of the firm performance measure of the seven firm performance variables. There are various reasons for conducting factor analysis, some of which include:

- (i) To select a subset of variables from a larger set based on which of the original variables give the highest correlations with the principal component factors,
- (ii) To validate a scale or index by demonstrating that its constituent items load on the same factor and subsequently exclude proposed scale items which cross-load on more than one factor,

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Table 6.8 : Descriptive Statistics of Firm Performance Measures (Year 2002-2004)

YEAR 2002	TOBQ02	MBE02	MBA02	ROA02	ROE02	ROI02	EARP02
Mean	0.9848	1.1987	0.5771	0.0303	0.0399	0.0180	-0.0107
Median	0.8758	0.8326	0.4383	0.0309	0.0626	0.0496	0.0400
Std. Dev.	0.6405	1.3640	0.6675	0.1147	0.3988	0.3345	0.3003
Skewness	5.8557	3.8524	5.8938	5.5951	-3.5646	-4.1279	-2.8838
Kurtosis	50.4632	17.1954	52.5038	67.1976	42.2110	57.3758	19.8832
Minimum	0.2856	-0.4544	0.0255	-0.4086	-3.6566	-3.3731	-2.2900
Maximum	7.4704	9.8933	7.4470	1.2919	2.3120	2.2069	1.2100
YEAR 2003	TOBQ03	MBE03	MBA03	ROA03	ROE03	ROI03	EARP03
Mean	0.8943	1.0693	0.4803	0.0292	0.0860	0.0844	0.0292
Median	0.7961	0.7048	0.3640	0.0381	0.0773	0.0637	0.0500
Std. Dev.	0.5319	1.5641	0.5313	0.1146	0.6110	0.8954	0.8615
Skewness	4.1070	6.0017	4.4944	-3.7953	6.2610	12.3087	0.3489
Kurtosis	24.8971	43.1865	30.1082	36.8768	74.3544	174.3920	23.3021
Minimum	0.1663	-0.7189	0.0000	-1.0412	-2.1740	-2.0812	-5.7300
Maximum	5.1387	14.7813	5.0863	0.5480	6.9077	12.5781	5.0400
YEAR 2004	TOBQ04	MBE04	MBA04	EROA04	EROE04	EROI04	EARP04
Mean	1.0261	1.5175	0.6404	0.0176	-0.1646	0.0355	0.0540
Median	0.9082	0.9243	0.4862	0.0400	0.0900	0.0724	0.0600
Std. Dev.	0.8324	4.2090	0.8462	0.1988	2.2934	0.3622	0.5707
Skewness	7.7711	12.2103	8.1010	-8.9193	-9.9721	-7.3848	5.3230
Kurtosis	83.0031	165.0863	88.9714	98.5895	100.5356	82.1776	64.3259
Minimum	0.0245	-2.4198	0.0196	-2.3500	-23.7900	-4.0984	-2.6200
Maximum	10.5973	59.1136	10.5537	0.2600	1.4000	1.4050	6.1100

N = 221 for the year 2002 and 2003; N = 216 for the year 2004

Notes: TOBQ = Tobin's Q, MBE = Market to Book Value of Equity, MBA = Market to Book Value of Asset, ROA = Return on Assets, ROE = Return on Equity, ROI = Return on Investment and EARP = Earnings Per Share/ Price, 02 = Year 2002, 03 = Year 2003, 04 = Year 2004

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Table 6.9 : Descriptive Statistic of the Normal Scores of the Firm Performance Measures (Year 2002 -2004)

YEAR 2002	NTOBQ02	NMBE02	NMBA02	NROA02	NROE02	NROI02	NEARP02
Mean	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Median	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0565
Std. Dev.	0.9813	0.9813	0.9813	0.9813	0.9813	0.9813	0.9806
Skewness	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	-0.0002
Kurtosis	-0.2179	-0.2179	-0.2179	-0.2179	-0.2179	-0.2179	-0.2140
Minimum	-2.6117	-2.6117	-2.6117	-2.6117	-2.6117	-2.6117	-2.6117
Maximum	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117
YEAR 2003	NTOBQ03	NMBE03	NMBA03	NROA03	NROE03	NROI03	NEARP03
Mean	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Median	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0056
Std. Dev.	0.9813	0.9813	0.9813	0.9813	0.9813	0.9813	0.9808
Skewness	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Kurtosis	-0.2179	-0.2179	-0.2179	-0.2179	-0.2179	-0.2179	-0.2140
Minimum	-2.6117	-2.6117	-2.6117	-2.6117	-2.6117	-2.6117	-2.6117
Maximum	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117
YEAR 2004	NTOBQ04	NMBE04	NMBA04	NROA04	NROE04	NROI04	NEARP04
Mean	0.0000	0.0000	0.0000	-0.0001	-0.0001	0.0000	0.0000
Median	0.0000	0.0000	0.0000	-0.0578	-0.0058	0.0000	0.0809
Std. Dev.	0.9809	0.9809	0.9809	0.9786	0.9802	0.9809	0.9802
Skewness	0.0000	0.0000	0.0000	-0.0016	-0.0016	0.0000	-0.0002
Kurtosis	-0.2205	-0.2205	-0.2205	-0.2083	-0.2202	-0.2210	-0.2145
Minimum	-2.6039	-2.6039	-2.6039	-2.6039	-2.6039	-2.6023	-2.6039
Maximum	2.6039	2.6039	2.6039	2.6039	2.6039	2.6023	2.6039
N = 221 for year 2002 and 2003; N = 216 for year 2004							
Notes: NTOBQ = Normal Scores of Tobin's Q, NMBE = Normal Scores of Market to Book Value of Equity, NMBA = Normal Scores of Market to Book Value of Assets, NROA = Normal Scores of Return on Assets, NROE = Normal Scores of Return on Equity, NROI = Normal Scores of Return on Investment and NEARP = Normal Scores of Earnings Per Share/ Price, 02 = Year 2002, 03 = Year 2003, 04 = Year 2004							

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- (iii) To reduce a large number of variables to a smaller number of factors for modelling purposes

[See further, for instance, Lawley and Maxwell, 1971; Kim and Mueller, 1978(a)(b); Field, 2005]

In the case of the current research, factor analysis was performed on the seven measures of firm performance as in 2002, 2003 and 2004 to reduce related variables into one common factor (Hair et al., 1998; Pallant, 2005). This data reduction technique is also useful to solve the multicollinearity problem in multiple regression where it combines variables that are collinear (Field, 2005: 619). In particular the principal component analysis (PCA) method of factor analysis is used to extract the factor from respective data sets. Specifically, this extraction method identifies a linear combination of variables such that maximum variance is extracted from the variables. Subsequently, it removes this variance and seeks a second linear combination which explains the maximum proportion of the remaining variance. The same process is carried out for the other variables in the data sets.

Specifically, factor analysis results, such as correlation matrix, Kaiser-Meyer-Olkin Measure of Sampling Adequacy (KMO) and Bartlett's Test of Sphericity (see Table 6.11) indicated the suitability of factor analysis as a method of data reduction for the seven firm performance variables. Moreover, according to Hair et al., (1998) and Pallant (2005), the factor analysis data reduction technique is applicable when there is a presence of values of correlation coefficients values of 0.3 and above (see Table 6.10), a KMO value of 0.6 and above, and Bartlett's Test significant value of 0.05 and below. By employing principal component analysis as the

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extraction method of principal factors of the seven firm performance measures, a Kaiser-Meyer Olkin Measure (KMO) value of 0.620 was obtained (see Table 6.11).

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		0.620
Bartlett's Test of Sphericity	Approx. Chi- square	1250.085
	df	21
	Sig	0.000

Further, due to the high correlation amongst some of the variables, firm performance variables were separated into market value measures (namely, the TOBQ, MBE, MBA) and accounting-based measures of firm performance (namely ROA, ROE, ROI and EARP) [see Table 6.10]. According to Pallant (2005), a factor analysis should be carried out on a set of variables with high correlation amongst them. In addition, factor analysis is suitable for data sets that give a KMO value higher than 0.6 (Hair et al., 1998; Tabachnick and Fidell, 2006). Respectively, principal component analysis of market value and accounting based measure of firm performance produced a KMO value of 0.648 and 0.636, higher than 0.62. As shown in Tables 6.12 and 6.13, Tobin's Q and ROE produced the highest eigenvalue and percentage of total variance than other performance measures in the three years observed [i.e. greater than 54%]. Based on this statistical result, Tobin's Q and ROE were appropriate component solutions for the respective market value and accounting based measures of firm performance and were used as firm performance measures in the current research models.

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Table 6.12 : Eigenvalues and Total Variance Derived From Principal Component Analysis of Market-Value Measures of Firm Performance

Components	Initial Eigenvalues	Extraction Sums of Squared Loadings		
	Total	Total	% of Variance	Cumulative %
Yr 2002 Tobin's Q	2.5726	2.5726	85.7522	85.7522
	0.3531		11.7702	97.5224
	0.0743		2.4476	100
Yr 2003 Tobin's Q	2.3539	2.3539	78.4623	78.4623
	0.5134		17.1142	95.5765
	0.1327		4.4236	100
Yr 2004 Tobin's Q	2.0315	2.0315	67.7178	67.7178
	0.8966		29.886	97.6038
	0.0719		2.3962	100

Table 6.13: Eigenvalues and Total Variance Derived From Principal Component Analysis of Accounting-Based Value Measures of Firm Performance

Components	Initial Eigenvalues	Extraction Sums of Squared Loadings			
	Total	Total	% of Variance	Cumulative %	
Yr 2002	ROE	2.6511	2.6511	66.2778	66.2778
	ROA	0.9430		23.5743	89.8521
	ROI	0.3380		8.4510	98.3031
	EARP	0.0679		1.6970	100
Yr 2003	ROE	2.3008	2.3008	57.5200	57.5200
	ROA	0.9575		23.9367	81.4567
	ROI	0.5109		12.7719	94.2286
	EARP	0.2309		5.7713	100
Yr 2004	ROE	2.2009	2.2009	55.0235	55.0235
	ROA	0.9171		25.4278	80.4513
	ROI	0.5490		16.2250	98.6763
	EARP	0.1330		3.3238	100

6.5.2 Explanatory Variables

In this section the discussion of the explanatory variables is divided into 4 parts, namely, board of directors', audit committee, nomination committee and remuneration committee corporate governance variables. In each section, the variable's descriptive statistic and correlation analysis are examined.

6.5.2.1 **Board of Director's Corporate Governance Variables**

(1) ***Board of Director Independence and Variables Characteristics***

Each listed company was required to identify its independent director in accordance to MBSB and MCCG (2001) definition (see further section 2.3.4.1). Such independent director definition is consistent with Cotter et al., (1997) who exclude a director who is currently or in the past an employee of the firm or having business or family ties with management. The proportion of independent director (INED) was calculated as the number of independent director to board size. This proxy is consistent with the measure used by Zajac and Westphal (1994) and Carcello et al., [2002(a)] in computing independent director percentage on the firm's board.

On average, the boards of the sampled firms comprised 39% (see Table 6.16) of independent directors which was slightly higher than the one-third minimum requirement of the MBSB⁵⁷. As shown in Table 6.16, there had been an increase in the proportion of independent director (INED) membership in 2003, such that there were more companies appointing more than one-third independent directors to the board. Also, the highest presence of independent directors on the board had increased from 83% to 88% (see Table 6.16). Subsequently, this variable was also transformed to normal scores to be consistent with the employment of normal scores in the dependent variables (i.e. firm performance measures, the Tobin's Q and ROE in Table 6.9). According to Cooke (1998), the transformation of both the continuous and discrete data of dependent and independent variables will assist in the interpretation of the regression results of the relationship between independent and dependent variables.

⁵⁷ Malaysia Bourse Securities Limited

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The variable domination of independent directors (DOINED), was calculated as the binary variable 1 when the firm's board comprised of more than 50% of independent directors. This proxy was consistent with Kesner et al.'s (1986) measure of domination of independent directors on the board. As shown in Table 6.14, there were 56 companies in 2003 with majority or more independent directors on their board in comparison to 47 companies in 2002. From observations of the 221 firms' corporate governance statements (in their annual reports 2002 and 2003), generally, most of the companies agreed that an improvement in the firm's corporate governance practice was important to protect shareholders' interests, enhance shareholders' value, improve the firm's reputation and attract further investment into the firm.

On the other hand, domination of independent and non-executive directors was computed as a binary variable 1 when there existed more than 50% of total independent and non-executive director on the board. This proxy was similar to Lee et al.'s (1992) measure of domination of independent and affiliated directors. Further, Table 6.14 showed that in 2002 (2003), there was 22% (16%) of the 221 companies had not fulfilled the MBSB minimum requirement for one-third independent director presence on their board. In their corporate governance statement, these companies explained that they had fulfilled the MBSB's requirement for one-third independent director presence with the appointment of non-executive directors such that the total of their independent and non-executive directors made up the one-third requirement. These companies also stated that the appointment of non-executive directors would ensure the establishment of independent views and judgement in board decisions.

Table 6.14: Distribution of Independent (INED), Non-Executive (NED) and Executive (ED) Directors in 221 Sampled Firms

Proportion of Different Types of Director on the Firm's Board	Year 2002			Year 2003		
	INED	NED	ED	INED	NED	ED
0	0	38	12	0	45	14
Less than 1/3	48	89	89	36	85	95
1/3	56	19	15	50	23	15
More than 1/3 but less than 50%	70	30	36	79	35	34
50% to less than two-thirds	42	41	68	27	31	58
Two-thirds or more	5	4	1	29	31	5
Total Firms	221	221	221	221	221	221

Table 6.15 provides information about the age groups of the board of directors' members in the 221 companies in 2002 and 2003. Many of the firms' board members were within the age range of 40 and above. The highest number of board members in firms was aged 50 to 59.

Table 6.15: Age Group of Board of Director of the 221 firms in Years 2002 and 2003

Age Group	Number of Director	
	Year 2002	Year 2003
Below 30	16	6
30 to 39	126	113
40 to 49	467	396
50 to 59	636	618
60 to 69	400	445
70 and above	130	122
Total Number of Directors	1775	1770

In addition, Table 6.16 presents the descriptive statistics of the explanatory variables of the research model OLS 1, which examined the impact of board independence on firm performance. As shown in Table 6.16, the continuous and discrete data of board independence variables were transformed to normal scores. The transformation improved the skewness and kurtosis level of the proportion of independent directors (INED), proportion of INED on the board with accounting and finance background (INACF), percentage of independent directors' shareholding

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Table 6.16: Descriptive Statistics of Board of Directors' Independence Variables for the Year 2002 and 2003

[Notes: BOD = Board of Directors, INED = Proportion of independent directors on BOD, DOMINED = Domination of BOD of 51% or more by INED, DOMNEDI = Domination of BOD of 51% or more of the Combination of Independent and Non Executive Directors, INACF = The proportion of INED on the board with accounting and finance background, SRINED = the presence of senior independent director on the BOD, EXCEO = the absence of CEO on BOD, CHINED = the present of independent BOD chairman, FOU = The presence of founder on the BOD, FAMDI = the presence of family member on BOD, INSDG = the percentage of independent directors' shareholding in the firm, NINED02 = Normal Scores of Proportion of INED in 2002, NINACF02 = Normal scores of INACF in 2002, NFAMDI02 = Normal Scores of NFAMDI in 2002, NINSDG02 = Normal Scores of INSDG in 2002, NINED03 = Normal Scores of Proportion of INED in 2003, NINACF03 = Normal scores of INACF in 2003, NFAMDI03 = Normal Scores of NFAMDI in 2003, NINSDG03 = Normal Scores of INSDG in 2003 (i.e. All Normal scores were calculated using the Van der Waerden approach)]

The Corporate Governance Variables of Board of Director Independence Research Models (Year 2002)										
Desrp. Stat	INED	DOMINED	DOMNEDI	INACF	SRINED	EXCEO	CHINED	FOUD	FAMDI	INSDG
Mean	0.3909	0.2127	0.8190	0.4156	0.4434	0.2308	0.2353	0.3303	0.1710	0.0023
Std Dev.	0.1113	0.4101	0.3859	0.4085	0.4979	0.4223	0.4252	0.4714	0.2047	0.0112
Skewness	0.991	1.414	-1.668	1.277	0.229	1.287	1.257	0.7265	0.73	10.416
Kurtosis	1.914	-0.001	0.791	2.415	-1.965	-0.347	-0.425	-1.4857	-0.815	128.09
Min	0.13	0	0	0	0	0	0	0.0000	0	0
Max	0.83	1	1	2	1	1	1	1.0000	0.71	0.15
The Corporate Governance Variables of Board of Director Independence Research Models (Year 2003)										
Desrp. Stat	INED	DOMINED	DOMNEDI	INACF	SRINED	EXCEO	CHINED	FOUD	FAMDI	INSDG
Mean	0.4145	0.2354	0.81	0.4224	0.4796	0.2896	0.2443	0.3122	0.1618	0.0016
Std Dev.	0.145	0.4359	0.3932	0.353	0.5007	0.4546	0.43067	0.4644	1984	0.0057
Skewness	1.094	1.142	-1.591	3.081	0.082	0.934	1.198	0.8160	0.811	0.164
Kurtosis	1.317	-0.703	0.536	-1.067	-2.012	-1.138	-0.57	-1.3464	-0.627	29.967
Min	0.2	0	0	0	0	0	0	0.0000	0	0
Max	0.88	1	1	1	1	1	1	1.0000	0.67	0.04
Normal Scores of BOD Variables										
Desrp. Stat	NINED02	NINACF02	NFAMDI02	NINSDG02	NINED03	NINACF03	NFAMDI03	NINSDG03		
Mean	0.0007	0.0336	0.0605	0.0499	0.0031	0.0317	0.0605	0.0553		
Std. Dev.	0.9688	0.9014	0.8262	0.8636	0.9672	0.9018	0.8197	0.8481		
Skewness	0.0004	0.4291	0.8357	0.6425	0.0242	0.4021	0.8341	0.7286		
Kurtosis	-0.1481	-0.6289	-0.3911	-0.5570	-0.1962	-0.6710	-0.4690	-0.4895		
Minimum	-2.6117	-1.0230	-0.6257	-0.7850	-2.4699	-1.0422	-0.6120	-0.7104		
Maximum	2.6117	2.6117	2.6117	2.6117	2.6117	2.3652	2.2111	2.6117		

N = 221

Table 6.17: Spearman's Correlation Analysis of Board Independence Variables (Year 2002) [2-tailed test]

[Notes: NINED03 = Normal Scores of Proportion of INED in 2003, NINACF03= Normal scores of INACF in 2003, NFAMDI03=Normal Scores of NFAMDI in 2003, NINDSG03 = Normal Scores of INDSG in 2003 (i.e. All normal scores were calculated using the Van der Waerden approach); Figures in italics represent the p value of the correlation]

Variables	NINED02	DOINED02	DONEDI02	NINACF02	SRI02	EXCEO02	CHIN02	FOUD02	NFAMDI02	NINSDG02
NINED02	1.0000	0.7163	0.2060	0.1964	-0.0107	0.1422	0.0894	-0.0613	-0.1315	0.0562
		<i>0.0000</i>	<i>0.0021</i>	<i>0.0034</i>	<i>0.8746</i>	<i>0.0346</i>	<i>0.1855</i>	<i>0.3647</i>	<i>0.0509</i>	<i>0.4059</i>
DOINED02	0.7163	1.0000	0.2443	0.1069	0.0258	0.1615	0.0767	-0.0594	-0.1504	-0.0181
	<i>0.0000</i>		<i>0.0002</i>	<i>0.1131</i>	<i>0.7031</i>	<i>0.0163</i>	<i>0.2564</i>	<i>0.3798</i>	<i>0.0253</i>	<i>0.7894</i>
DONEDI02	0.2060	0.2443	1.0000	-0.0561	0.0411	0.1180	-0.0994	-0.0447	-0.1677	-0.0100
	<i>0.0021</i>	<i>0.0002</i>		<i>0.4063</i>	<i>0.5433</i>	<i>0.0800</i>	<i>0.1407</i>	<i>0.5089</i>	<i>0.0126</i>	<i>0.8827</i>
NINACF02	0.1964	0.1069	-0.0561	1.0000	0.0825	0.0640	-0.1715	0.0427	-0.0233	-0.0432
	<i>0.0034</i>	<i>0.1131</i>	<i>0.4063</i>		<i>0.2218</i>	<i>0.3433</i>	<i>0.0107</i>	<i>0.5281</i>	<i>0.7304</i>	<i>0.5230</i>
SRI02	-0.0107	0.0258	0.0411	0.0825	1.0000	-0.1862	-0.1301	0.1090	0.0347	0.0868
	<i>0.8746</i>	<i>0.7031</i>	<i>0.5433</i>	<i>0.2218</i>		<i>0.0055</i>	<i>0.0534</i>	<i>0.1061</i>	<i>0.6082</i>	<i>0.1989</i>
EXCEO02	0.1422	0.1615	0.1180	0.0640	-0.1862	1.0000	-0.0320	-0.1335	-0.1924	-0.1232
	<i>0.0346</i>	<i>0.0163</i>	<i>0.0800</i>	<i>0.3433</i>	<i>0.0055</i>		<i>0.5640</i>	<i>0.0475</i>	<i>0.0041</i>	<i>0.0676</i>
CHIN02	0.0894	0.0767	-0.0994	-0.1715	-0.1301	-0.0320	1.0000	-0.3442	-0.0986	0.0762
	<i>0.1855</i>	<i>0.2564</i>	<i>0.1407</i>	<i>0.0107</i>	<i>0.0534</i>	<i>0.5640</i>		<i>0.0000</i>	<i>0.1439</i>	<i>0.2596</i>
FOUD02	-0.0613	-0.0594	-0.0447	0.0427	0.1090	-0.1335	-0.3442	1.0000	0.5905	0.0314
	<i>0.3647</i>	<i>0.3798</i>	<i>0.5089</i>	<i>0.5281</i>	<i>0.1061</i>	<i>0.0475</i>	<i>0.0000</i>		<i>0.0000</i>	<i>0.6421</i>
NFAMDI02	-0.1315	-0.1504	-0.1677	-0.0233	0.0347	-0.1924	-0.0986	0.5905	1.0000	0.1748
	<i>0.0509</i>	<i>0.0253</i>	<i>0.0126</i>	<i>0.7304</i>	<i>0.6082</i>	<i>0.0041</i>	<i>0.1439</i>	<i>0.0000</i>		<i>0.0092</i>
NINSDG02	0.0562	-0.0181	-0.0100	-0.0432	0.0868	-0.1232	0.0762	0.0314	0.1748	1.0000
	<i>0.4059</i>	<i>0.7894</i>	<i>0.8827</i>	<i>0.5230</i>	<i>0.1989</i>	<i>0.0676</i>	<i>0.2596</i>	<i>0.6421</i>	<i>0.0092</i>	

Table 6.18: Spearman's Correlation Analysis of Board Independence Variables (Year 2003) [2-tailed test]

[Notes: NINED03 = Normal scores of Proportion of INED in 2003, NINACF03 = Normal scores of INACF in 2003, NFAMDI03 = Normal Scores of NFAMDI in 2003, NINDSG03 = Normal Scores of INDSG in 2003 (i.e. All normal scores were calculated using the Van der Waerden approach; Figures in italics represent the p value of the correlation)]

Variables	NINED03	DOINED03	DONEDI03	NINACF03	SRI03	EXCEO03	CHIN03	FOUD03	NFAMDI03	NINSDG03
NINED03	1.0000	0.4010	0.3274	0.2055	0.0009	0.1306	0.2194	-0.2159	-0.1989	0.0420
DOINED03		<i>0.0000</i>	<i>0.0000</i>	<i>0.0021</i>	<i>0.9890</i>	<i>0.0526</i>	<i>0.0010</i>	<i>0.0012</i>	<i>0.0030</i>	<i>0.5350</i>
DONEDI03	0.4010	1.0000	0.1807	0.0588	0.0567	0.1578	0.0773	-0.1321	-0.0116	-0.0795
	<i>0.0000</i>		<i>0.0071</i>	<i>0.3845</i>	<i>0.4017</i>	<i>0.0189</i>	<i>0.2527</i>	<i>0.0499</i>	<i>0.8643</i>	<i>0.2390</i>
NINACF03	0.3274	0.1807	1.0000	0.1040	0.0033	0.1567	0.0070	-0.1714	-0.1901	0.0670
	<i>0.0000</i>	<i>0.0071</i>		<i>0.1232</i>	<i>0.9606</i>	<i>0.0198</i>	<i>0.9171</i>	<i>0.0107</i>	<i>0.0046</i>	<i>0.3217</i>
SRI03	0.2055	0.0588	0.1040	1.0000	-0.0057	0.0167	-0.0351	-0.0558	-0.0755	-0.0496
	<i>0.0021</i>	<i>0.3845</i>	<i>0.1232</i>		<i>0.9330</i>	<i>0.8046</i>	<i>0.6039</i>	<i>0.4088</i>	<i>0.2640</i>	<i>0.4631</i>
EXCEO03	0.0009	0.0567	0.0033	-0.0057	1.0000	-0.0738	-0.0611	0.0568	0.0320	-0.0042
	<i>0.9890</i>	<i>0.4017</i>	<i>0.9606</i>	<i>0.9330</i>		<i>0.2745</i>	<i>0.3657</i>	<i>0.4009</i>	<i>0.6361</i>	<i>0.9504</i>
CHIN03	0.1306	0.1578	0.1567	0.0167	-0.0738	1.0000	-0.0380	-0.0857	-0.1661	-0.0182
	<i>0.0526</i>	<i>0.0189</i>	<i>0.0198</i>	<i>0.8046</i>	<i>0.2745</i>		<i>0.5739</i>	<i>0.2043</i>	<i>0.0134</i>	<i>0.7878</i>
FOUD03	0.2194	0.0773	0.0070	-0.0351	-0.0611	-0.0380	1.0000	-0.3604	-0.1016	0.0968
	<i>0.0010</i>	<i>0.2527</i>	<i>0.9171</i>	<i>0.6039</i>	<i>0.3657</i>	<i>0.5739</i>		<i>0.0000</i>	<i>0.1323</i>	<i>0.1516</i>
NFAMDI03	-0.2159	-0.1321	-0.1714	-0.0558	0.0568	-0.0857	-0.3604	1.0000	0.5839	0.0729
	<i>0.0012</i>	<i>0.0499</i>	<i>0.0107</i>	<i>0.4088</i>	<i>0.4009</i>	<i>0.2043</i>	<i>0.0000</i>		<i>0.0000</i>	<i>0.2806</i>
NINSDG03	-0.1989	-0.0116	-0.1901	-0.0755	0.0320	-0.1661	-0.1016	0.5839	1.0000	0.1263
	<i>0.0030</i>	<i>0.8643</i>	<i>0.0046</i>	<i>0.2640</i>	<i>0.6361</i>	<i>0.0134</i>	<i>0.1323</i>	<i>0.0000</i>		<i>0.0610</i>
	0.0420	-0.0795	0.0670	-0.0496	-0.0042	-0.0182	0.0968	0.0729	0.1263	1.0000
	<i>0.5350</i>	<i>0.2390</i>	<i>0.3217</i>	<i>0.4631</i>	<i>0.9504</i>	<i>0.7878</i>	<i>0.1516</i>	<i>0.2806</i>	<i>0.0610</i>	

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in the firm (INSDG), and proportion of family-member directors (FAMDI) in year 2002 and 2003. Further, Tables 6.17 and 6.18 present the correlation analysis of board independence variables in 2002 and 2003 respectively. The analysis indicated that all the board independence variables had a low correlation (i.e. r less than 0.6) with respective observed variables (i.e. as identified in Chapter 5).

(II) *Board of Directors' Leadership and Variables Characteristics*

As reported in Table 6.19, leadership of the Board of Directors of the 221 sampled firms varied in terms of the chairman's independence. Also, year 2003 results pointed that that a slight increase in the number of companies appointing an independent director as the board's chairman. In addition, many companies had adopted a separate position for their CEO and board's chairman. At the same time, companies which were controlled by family members had gradually reduced their family members' appointment as the board chairman.

In addition, Table 6.20 below presents the correlation analysis of the board leadership variables for the year 2002 and 2003. The correlation between the board leadership variables is less than 0.6.

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Table 6.19: Descriptive Statistics of Board of Director Leadership Variables (Yr 2002-2003)

(Notes: CHINED = Board's Chairman is independent director, CHSINED = Board's Chairman is senior independent director, CHFOUND = Board's Chairman is founder, CHNOM = Board's Chairman is non executive director and CHFAM = Board's Chairman is family member, SEPCEO = Separate board chairman and CEO position)

Year	Descrp. Stat.	Corporate Governance Variables of Board Leadership					
		CHINED	CHSINED	CHFOUND	CHNOM	CHFAM	SEPCEO
Year 2002	Mean	0.2353	0.0136	0.099	0.4253	0.3303	0.8914
	Std Dev.	0.4252	0.1160	0.3001	0.4955	0.4714	0.3118
	Skewness	1.257	8.465	2.693	0.304	0.726	-2.533
	Kurtosis	-0.425	70.288	5.302	-1.925	-1.486	4.457
	Min	0	0	0	0	0	0
	Max	1	1	1	1	1	1
	Freq	52	3	22	94	73	197
Year	Descrp. Stat.	Corporate Governance Variables of Board Leadership					
		CHINED	CHSINED	CHFOUND	CHNOM	CHFAM	SEPCEO
Year 2003	Mean	0.2443	0.0181	0.0995	0.3529	0.3122	0.914
	Std Dev.	0.4307	0.1336	0.3001	0.479	0.4644	0.281
	Skewness	1.198	7.279	2.693	0.62	0.816	-2.974
	Kurtosis	-0.57	51.45	5.302	-1.631	-1.346	6.908
	Min	0	0	0	0	0	0
	Max	1	1	1	1	1	1
	Freq	54	4	22	78	69	202
Board of Directors Structure							
BOD Chairman	Yr 2002			Yr 2003			
	INED	NED	ED	INED	NED	ED	
	54	82	85	54	78	85	
BOD Size							
Descrp. Stat	Yr 2002	Yr 2003					
Max	16	14					
Min	4	3					
Mean	7.9729	7.968					
Std Dev	2.0648	1.9912					
N = 221 firms							

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Table 6.20: Spearman's Correlation Analysis of Board Leadership Variables (Yr 2002-2003) [2-tailed test]

(Notes: CHINED = Board's Chairman is independent director, CHSINED = Board's Chairman is senior independent director, CHFOUND = Board's Chairman is founder, CHNOM = Board's Chairman is non executive director and CHFAM = Board's Chairman is family member, SEPCEO= Separate board's chairman and CEO position; 02 = Year 2002, 03 = Year 2003; Figures in italic represent the p-value of variables' correlation)

Variables	CHIN02	CHSIN02	CHFOU02	CHNED02	CHFAM02	SEPCEO02
CHIN02	1.0000	0.2115	-0.1488	-0.3262	-0.3442	0.1593
		<i>0.0016</i>	<i>0.0270</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.0178</i>
CHSIN02	0.2115	1.0000	-0.0390	-0.1009	-0.0824	0.0409
	<i>0.0016</i>		<i>0.5641</i>	<i>0.1347</i>	<i>0.2225</i>	<i>0.5448</i>
CHFOU02	-0.1488	-0.0390	1.0000	-0.1943	0.4734	-0.2725
	<i>0.0270</i>	<i>0.5641</i>		<i>0.0037</i>	<i>0.0000</i>	<i>0.0000</i>
CHNED02	-0.3262	-0.1009	-0.1943	1.0000	-0.1761	0.2415
	<i>0.0000</i>	<i>0.1347</i>	<i>0.0037</i>		<i>0.0087</i>	<i>0.0003</i>
CHFAM02	-0.3442	-0.0824	0.4734	-0.1761	1.0000	-0.3424
	<i>0.0000</i>	<i>0.2225</i>	<i>0.0000</i>	<i>0.0087</i>		<i>0.0000</i>
SEPCEO02	0.1593	0.0409	-0.2725	0.2415	-0.3424	1.0000
	<i>0.0178</i>	<i>0.5448</i>	<i>0.0000</i>	<i>0.0003</i>	<i>0.0000</i>	
Variables	CHIN03	CHSIN03	CHFOU03	CHNED03	CHFAM03	SEPCEO03
CHIN03	1.0000	0.1598	-0.1891	-0.4200	-0.3604	0.1744
		<i>0.0175</i>	<i>0.0048</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.0094</i>
CHSIN03	0.1598	1.0000	-0.0451	-0.0292	-0.0915	0.0416
	<i>0.0175</i>		<i>0.5044</i>	<i>0.6655</i>	<i>0.1754</i>	<i>0.5380</i>
CHFOU03	-0.1891	-0.0451	1.0000	-0.1191	0.4935	-0.1137
	<i>0.0048</i>	<i>0.5044</i>		<i>0.0774</i>	<i>0.0000</i>	<i>0.0918</i>
CHNED03	-0.4200	-0.0292	-0.1191	1.0000	-0.1502	0.2265
	<i>0.0000</i>	<i>0.6655</i>	<i>0.0774</i>		<i>0.0255</i>	<i>0.0007</i>
CHFAM03	-0.3604	-0.0915	0.4935	-0.1502	1.0000	-0.2114
	<i>0.0000</i>	<i>0.1754</i>	<i>0.0000</i>	<i>0.0255</i>		<i>0.0016</i>
SEPCEO03	0.1744	0.0416	-0.1137	0.2265	-0.2114	1.0000
	<i>0.0094</i>	<i>0.5380</i>	<i>0.0918</i>	<i>0.0007</i>	<i>0.0016</i>	

(III) *Board of Directors' Competency and Variables Characteristics*

Table 6.21 presents the descriptive statistics for board of directors' educational level and areas of expertise. As shown in Table 6.21 many of the 221 sampled firms' board of directors' members were degree holders. From companies' annual reports, the study gathered that engineer, doctor, accountant and lawyer (which included advocate and solicitor) were common groups of professionals being appointed to firms' board. It was also observed that, directors with accounting background comprised of the largest group of experts being appointed to the firm's board in comparison to directors with a finance, law and business background (see Table 6.21).

Further, in measuring board of directors' educational level, a score of 2, 4, 6 and 8 was respectively allocated to board members who had a Bachelor degree, Master's, Professional qualification and Doctor of Philosophy. The impact of proportion of director in the board with Bachelor degree (DEG), Master's (MASK), Professional qualification (PROFL) and Doctor of Philosophy (PHD) on firm performance was measured by their respective total scores. Subsequently, the scores of directors' educational level were transformed to normal scores using the Van der Waerden approach to be consistent with dependent variable measurement (see Cooke, 1998).

Board members' areas of expertise were also examined in terms of the proportion of directors with an accounting (ACTG), finance (FIN), business (BUS) and law (LAW) qualification, and who had attended an executive management programme (EXEP), and had a company secretary experience [i.e. Number of directors with respective expertise to board size] . Directors with an accounting qualification represented individuals with accounting/auditing knowledge and

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experience where the knowledge had been acquired through degree, master, PhD, and/or professional accounting qualification, such as the FCCA, IPA (Singapore), ASCPA, ICPA, CPA, AIA, CA, CIMA, MACPA⁵⁸, in-house experience (such as being an accountant by training), and membership of a related accounting organisations such as the AIT, MASB, IIA, MIT, MICPA and MIA⁵⁹.

With respect to director, with a finance qualification, they included directors with a professional qualification such as the Certified Financial Analyst, Certified Financial Planner, Certificate from the Institute of Bankers, London, bankers, chief financial officer, CEO, insurer, financial advisor, and members of banking and financial organisations (such as the Institute of Canadian Bankers, the Malaysia Fellowship Institute of Bankers, and so on).

In addition directors with a legal background were described as those with law degree (i.e. bachelor, master's and/or PhD), or by occupation were mostly barristers, lawyers, advocates, solicitors and legal advisors. Directors' enrolment in an executive management programme indicated their participation in an Advanced Management Programme (AMP), Senior Management Programme (SMP) and Executive Management Programme (EMP) as conducted by top business schools such as Harvard University, Stanford University, INSEAD University, Wharton University, London Business School, etc.

⁵⁸ Malaysia Association of Chartered Public Accountants.

⁵⁹ Australia Institute of Taxation, Malaysia Accounting Standards Board, Malaysia Institute of Internal Auditors, Malaysia Institute of Taxation, Malaysia Institute of Certified Public Accountants, Malaysia Institute of Accountants.

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Table 6.21: Descriptive Statistics of Board of Director Competency Variables (Yr 2002- 2003

[Notes: DEG = Proportion of directors with bachelor degree, MASK = Proportion of directors with Master's degree, PhD= Proportion of directors with Doctor of Philosophy degree, PROFL = Proportion of director with professional qualification, ACTGK = Proportion of directors with accounting related qualification, FINK = proportion of directors with finance related qualification, BUSK = Proportion of directors with business related qualification, LAW = Proportion of directors with law related qualification, EXEPROG = Proportion of directors who had attended executive related management program or advanced management programme or senior executive programme, CHASEC = Proportion of directors with company secretary experience and/or ICSA (Institute of Chartered Secretarial and Administrator)]

Descrp. Stat	Corporate Governance Variables of Board of Director Knowledge and Skills (Yr 2002)									
	DEG	MASK	PHD	PROFL	ACTGK	FINK	BUSK	LAWK	EXEPROG	CHASEC
Mean	8.4706	6.0814	18.2443	2.0995	0.1436	0.2634	0.0608	0.0908	0.0246	0.0151
Median	8	4	18	0	2.0769	0.4796	1.1358	0.7376	0.1946	0.1222
Std Dev	4.3521	5.2926	9.5095	4.4731	0.1379	0.1493	0.1078	0.1136	0.0732	0.0575
Skewness	0.5332	1.1378	0.6653	2.5153	0.936	0.651	2.146	1.413	3.515	5.365
Kurtosis	-0.029	1.529	0.155	7.373	0.89	0.939	5.136	2.712	13.111	37.406
Min	0	0	0	0	0.00	0.00	0.00	0.00	0.00	0.00
Max	22	28	48	24	0.67	0.86	0.6	0.63	0.44	0.55
Total number of board of director members with Respective Knowledge and Skills in Year 2002										
	DEG	MASK	PHD	PROFL	ACTGK	FINK	BUSK	LAWK	EXEPROG	CHASEC
Sum	936	336	58	672	459	106	251	163	43	27
Descrp. Stat	Corporate Governance Variables of Board of Director Knowledge and Skills (Yr 2003)									
	DEG	MASK	PHD	PROFL	ACTGK	FINK	BUSK	LAWK	EXEPROG	CHASEC
Mean	8.8959	5.7376	17.5113	1.8824	0.2545	0.0682	0.1506	0.0949	0.0207	0.0104
Median	8	4	18	0	1.9231	0.5294	1.1267	0.7285	0.1674	0.0814
Std Dev	4.3247	4.7505	9.4569	4.3069	0.1411	0.10798	0.1328	0.1209	0.0612	0.0384
Skewness	0.5330	0.9790	0.8595	2.9429	0.872	1.873	0.480	1.508	3.270	4.015
Kurtosis	0.0432	0.9495	0.9802	12.0785	1.245	4.139	-0.691	3.07	11.148	16.997
Min	0	0	0	0	0.00	0.00	0.00	0.00	0.00	0.00
Max	22	24	54	32	0.86	0.57	0.50	0.67	0.38	0.25
Total number of board of director members with Respective Knowledge and Skills in Year 2003										
	DEG	MASK	PHD	PROFL	ACTGK	FINK	BUSK	LAWK	EXEPROG	CHASEC
Sum	983	317	52	645	425	117	249	161	37	18
Board of Directors Qualification and Experience										
(i) <u>Educational Background</u>				2002	2003					
Lower Undergraduate				30	28					
Postgraduate				70	72					
Professional				50	58					
Others				40	45					
				31	18					
(ii) <u>Experience</u>										
Private Sector				149	134					
Public Sector				72	87					
N = 221 firms										

Table 6.22: Descriptive Statistics of Normal Scores of Board of Directors Competency Variables (Yr 2002-2003)

[Notes: NDEG = Normal scores of proportion of directors with bachelor degree, NMASK = Normal scores of proportion of directors with Master's degree, NPhD= Normal scores of proportion of directors with Doctor of Philosophy degree, NPROFL = Normal scores of proportion of directors with professional qualification, NACTGK = Normal scores of proportion of directors with accounting related qualification, NFINK = Normal scores of proportion of directors with finance related qualification, NBUSK = Normal scores of proportion of directors with business related qualification, NLAW = Normal scores of proportion of directors with law related qualification, NEXEPROG = Normal scores of proportion of directors who had attended executive related management program or advanced management programme or senior executive programme, NCHASEC = Normal scores of proportion of directors with company secretary experience and/or ICSA (Institute of Chartered Secretarial and Administrator); 02 = Year 2002, 03 = Year 2003]

Descrip. Stat.	NDEG02	NMASK02	NPHD02	NPROFL02	NACTGK02	NFINK02	NBUSK02	NLAWK02	NEXEP02	NCHASEC02
Mean	0.0068	0.0224	0.0653	0.0107	0.0042	0.0728	0.0370	0.0587	0.0655	0.0547
Median	0.0113	-0.2568	-0.2744	0.0905	0.0395	-0.4122	0.0056	-0.6534	-0.1645	-0.1075
Std Dev.	0.9523	0.8995	0.6675	0.9356	0.9651	0.7601	0.8908	0.8333	0.6088	0.5391
Skewness	0.0881	0.3178	1.6760	0.1238	0.0760	1.2574	0.4730	0.7988	2.4515	3.1710
Kurtosis	-0.3292	-0.4506	1.5205	-0.2795	-0.3864	0.3477	-0.6334	-0.4220	4.6304	8.6680
Min	-2.6117	-1.2128	-0.2744	-2.4699	-1.8279	-0.4122	-0.9584	-0.6534	-0.1645	-0.1075
Max	2.4699	2.6117	2.3652	2.4699	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117
Descrip. Stat.	NDEG03	NMASK03	NPHD03	NPROFL03	NACTGK03	NFINK03	NBUSK03	NLAWK03	NEXEP03	NCHASEC03
Mean	0.0047	0.0216	0.0656	0.0085	0.0028	0.0701	0.0348	0.0586	0.0638	0.0514
Median	-0.1075	-0.2220	-0.2452	0.1989	-0.0848	-0.4745	0.0452	-0.6534	-0.1530	-0.0961
Std Dev.	0.9573	0.8957	0.6525	0.9395	0.9686	0.7827	0.8963	0.8332	0.5971	0.5197
Skewness	0.0607	0.3043	1.8263	0.0842	0.0520	1.1086	0.4424	0.7998	2.5650	3.3702
Kurtosis	-0.2835	-0.3942	2.0146	-0.1770	-0.3335	0.0412	-0.6512	-0.4155	5.1954	9.9268
Min	-2.6117	-1.2489	-0.2452	-2.2111	-1.9638	-0.4745	-0.9948	-0.6534	-0.1530	-0.0961
Max	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117	2.4699	2.6117	2.6117	2.4699

Table 6.23: Spearman's Correlation Analysis of Board of Directors' Competency Variables (Year 2002) [2-tailed test]

[Notes: NDEG = Normal scores of proportion of directors with bachelor degree, NMASK = Normal scores of proportion of directors with Master's degree, NPHD= Normal scores of proportion of directors with Doctor of Philosophy degree, NPROFL = Normal scores of proportion of directors with professional qualification, NACTGK = Normal scores of proportion of directors with accounting related qualification, NFINK = Normal scores of proportion of directors with finance related qualification, NBUSK = Normal scores of proportion of directors with business related qualification, NLAW = Normal scores of proportion of directors with law related qualification, NEXEPROG = Normal scores of proportion of directors who had attended executive related management programme or advanced management programme or senior executive program, NCHASEC = Normal scores of proportion of directors with company secretary experience and/or ICSA (Institute of Chartered Secretarial and Administrator, 02 = Year 2002, Figures in italics represent the p-value of the variables' correlation]

Variables	NDEG02	NMASK02	NPHD02	NPROFL02	NACTGK02	NFINK02	NBUSK02	NLAWK02	NEXEP02	NCHASEC02
NDEG02	1.0000	0.4772	0.2530	0.1956	-0.1678	-0.0074	0.0773	0.2266	0.0840	-0.0879
		<i>0.0000</i>	<i>0.0001</i>	<i>0.0035</i>	<i>0.0125</i>	<i>0.9125</i>	<i>0.2523</i>	<i>0.0007</i>	<i>0.2135</i>	<i>0.1929</i>
NMASK02	0.4772	1.0000	0.1806	0.1724	0.0674	0.1047	0.2692	0.0639	0.1708	-0.0742
	<i>0.0000</i>		<i>0.0071</i>	<i>0.0102</i>	<i>0.3185</i>	<i>0.1208</i>	<i>0.0001</i>	<i>0.3448</i>	<i>0.0110</i>	<i>0.2721</i>
NPHD02	0.2530	0.1806	1.0000	0.1455	0.1193	0.0772	-0.0273	0.2520	-0.0016	-0.0134
	<i>0.0001</i>	<i>0.0071</i>		<i>0.0306</i>	<i>0.0768</i>	<i>0.2534</i>	<i>0.6862</i>	<i>0.0002</i>	<i>0.9816</i>	<i>0.8424</i>
NPROFL02	0.1956	0.1724	0.1455	1.0000	-0.0444	0.1204	-0.0057	0.0619	-0.0076	-0.0885
	<i>0.0035</i>	<i>0.0102</i>	<i>0.0306</i>		<i>0.5119</i>	<i>0.0741</i>	<i>0.9324</i>	<i>0.3601</i>	<i>0.9109</i>	<i>0.1897</i>
NACTGK02	-0.1678	0.0674	0.1193	-0.0444	1.0000	0.2199	0.0483	-0.2096	-0.0121	-0.0259
	<i>0.0125</i>	<i>0.3185</i>	<i>0.0768</i>	<i>0.5119</i>		<i>0.0010</i>	<i>0.4751</i>	<i>0.0017</i>	<i>0.8584</i>	<i>0.7018</i>
NFINK02	-0.0074	0.1047	0.0772	0.1204	0.2199	1.0000	0.0709	0.0131	-0.0874	0.0428
	<i>0.9125</i>	<i>0.1208</i>	<i>0.2534</i>	<i>0.0741</i>	<i>0.0010</i>		<i>0.2937</i>	<i>0.8470</i>	<i>0.1954</i>	<i>0.5270</i>
NBUSK02	0.0773	0.2692	-0.0273	-0.0057	0.0483	0.0709	1.0000	0.0676	0.1095	0.0402
	<i>0.2523</i>	<i>0.0001</i>	<i>0.6862</i>	<i>0.9324</i>	<i>0.4751</i>	<i>0.2937</i>		<i>0.3172</i>	<i>0.1044</i>	<i>0.5522</i>
NLAWK02	0.2266	0.0639	0.2520	0.0619	-0.2096	0.0131	0.0676	1.0000	0.0334	-0.0793
	<i>0.0007</i>	<i>0.3448</i>	<i>0.0002</i>	<i>0.3601</i>	<i>0.0017</i>	<i>0.8470</i>	<i>0.3172</i>		<i>0.6211</i>	<i>0.2402</i>
NEXEP02	0.0840	0.1708	-0.0016	-0.0076	-0.0121	-0.0874	0.1095	0.0334	1.0000	-0.0767
	<i>0.2135</i>	<i>0.0110</i>	<i>0.9816</i>	<i>0.9109</i>	<i>0.8584</i>	<i>0.1954</i>	<i>0.1044</i>	<i>0.6211</i>		<i>0.2562</i>
NCHASEC02	-0.0879	-0.0742	-0.0134	-0.0885	-0.0259	0.0428	0.0402	-0.0793	-0.0767	1.0000
	<i>0.1929</i>	<i>0.2721</i>	<i>0.8424</i>	<i>0.1897</i>	<i>0.7018</i>	<i>0.5270</i>	<i>0.5522</i>	<i>0.2402</i>	<i>0.2562</i>	

Table 6.24: Spearman's Correlation Analysis of Board of Director's Competency Variables (Year 2003) [2-tailed test]

[Notes: NDEG = Normal scores of proportion of directors with bachelor degree, NMASK = Normal scores of proportion of director with masters degree, NPHD= Normal scores of proportion of directors with Doctor of Philosophy degree, NPROFL = Normal scores of proportion of directors with professional qualification, NACTGK = Normal scores of proportion of directors with accounting related qualification, NFINK = Normal scores of proportion of directors with finance related qualification, NBUSK = Normal scores of proportion of directors with business related qualification, NLAW = Normal scores of proportion of directors with law related qualification, NEXEPROG = Normal scores of proportion of directors who had attended executive related management programme or advanced management programme or senior executive programme, NCHASEC = Normal scores of proportion of directors with company secretary experience and/or ICSA (Institute of Chartered Secretarial and Administrator, 03 = Year 2003, Figures in italics represent the p- value of the correlation]

Variables	NDEG03	NMASK03	NPHD03	NPROFL03	NACTGK03	NFINK03	NBUSK03	NLAWK03	NEXEP03	NCHASEC03
NDEG03	1.0000	0.3011	0.1981	0.1478	-0.2673	-0.0433	0.0879	0.3553	0.1203	-0.1756
		<i>0.0000</i>	<i>0.0031</i>	<i>0.0280</i>	<i>0.0001</i>	<i>0.5217</i>	<i>0.1928</i>	<i>0.0000</i>	<i>0.0743</i>	<i>0.0089</i>
NMASK03	0.3011	1.0000	0.2214	-0.0587	-0.0363	0.0596	0.2790	0.0206	0.0646	-0.0240
	<i>0.0000</i>		<i>0.0009</i>	<i>0.3853</i>	<i>0.5915</i>	<i>0.3780</i>	<i>0.0000</i>	<i>0.7602</i>	<i>0.3390</i>	<i>0.7230</i>
NPHD03	0.1981	0.2214	1.0000	0.0256	-0.1026	0.1930	-0.0367	0.0224	0.0909	-0.0973
	<i>0.0031</i>	<i>0.0009</i>		<i>0.7054</i>	<i>0.1282</i>	<i>0.0040</i>	<i>0.5876</i>	<i>0.7402</i>	<i>0.1782</i>	<i>0.1495</i>
NPROFL03	0.1478	-0.0587	0.0256	1.0000	0.2525	0.1180	-0.0566	0.2302	0.0125	-0.0823
	<i>0.0280</i>	<i>0.3853</i>	<i>0.7054</i>		<i>0.0001</i>	<i>0.0802</i>	<i>0.4022</i>	<i>0.0006</i>	<i>0.8533</i>	<i>0.2231</i>
NACTGK03	-0.2673	-0.0363	-0.1026	0.2525	1.0000	0.0997	0.0032	-0.1203	-0.1232	-0.0510
	<i>0.0001</i>	<i>0.5915</i>	<i>0.1282</i>	<i>0.0001</i>		<i>0.1394</i>	<i>0.9628</i>	<i>0.0742</i>	<i>0.0675</i>	<i>0.4510</i>
NFINK03	-0.0433	0.0596	0.1930	0.1180	0.0997	1.0000	-0.0155	0.0592	-0.0195	-0.0327
	<i>0.5217</i>	<i>0.3780</i>	<i>0.0040</i>	<i>0.0802</i>	<i>0.1394</i>		<i>0.8192</i>	<i>0.3811</i>	<i>0.7731</i>	<i>0.6287</i>
NBUSK03	0.0879	0.2790	-0.0367	-0.0566	0.0032	-0.0155	1.0000	0.0007	0.0012	-0.0017
	<i>0.1928</i>	<i>0.0000</i>	<i>0.5876</i>	<i>0.4022</i>	<i>0.9628</i>	<i>0.8192</i>		<i>0.9920</i>	<i>0.9863</i>	<i>0.9799</i>
NLAWK03	0.3553	0.0206	0.0224	0.2302	-0.1203	0.0592	0.0007	1.0000	0.0088	-0.1377
	<i>0.0000</i>	<i>0.7602</i>	<i>0.7402</i>	<i>0.0006</i>	<i>0.0742</i>	<i>0.3811</i>	<i>0.9920</i>		<i>0.8961</i>	<i>0.0409</i>
NEXEP03	0.1203	0.0646	0.0909	0.0125	-0.1232	-0.0195	0.0012	0.0088	1.0000	0.0954
	<i>0.0743</i>	<i>0.3390</i>	<i>0.1782</i>	<i>0.8533</i>	<i>0.0675</i>	<i>0.7731</i>	<i>0.9863</i>	<i>0.8961</i>		<i>0.1575</i>
NCHASEC03	-0.1756	-0.0240	-0.0973	-0.0823	-0.0510	-0.0327	-0.0017	-0.1377	0.0954	1.0000
	<i>0.0089</i>	<i>0.7230</i>	<i>0.1495</i>	<i>0.2231</i>	<i>0.4510</i>	<i>0.6287</i>	<i>0.9799</i>	<i>0.0409</i>	<i>0.1575</i>	

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Table 6.22 presents the descriptive statistics of the normal scores of board of directors' educational level and areas of expertise. In addition, Tables 6.23 and 6.24 report the correlation analysis of board of directors' competency variables. The results of the analysis indicated that the correlation amongst board competency variables was low (i.e. r less than 0.4)

6.5.2.2 Audit Committee Corporate Governance Variables

(I) *Audit Committee Independence and Variables Characteristics*

With respect to the independence of the audit committee (AC) of the 221 Malaysian firms, there had been an improvement in the composition of independent directors on these committees (see Tables 6.25 and 6.27). For instance in 2003, almost 100% of the sampled firms had 50% or higher independent directors (INED) on their AC.

Table 6.25: Audit Committee and Independence Characteristics (Yr 2002-2003)

Audit Committee Independence Characteristics	Frequency (N = 221 Firms)	
	Yr 2002	Yr 2003
Audit Committee Members 100% Independent Director (AUDF)	22 (10%)	20 (9%)
Audit Committee Members 50% or more Independent Director (AUDMJ)	207 (94%)	219 (99%)
Audit Committee Members More than 50% Independent Director (AUGMJ)	202 (91%)	213 (96%)
The presence of a Senior Independent Director on AC (ACSIN)	88 (40%)	93 (42%)
CEO is not AC member (AXCEO)	189 (86%)	214 (97%)
The presence of independent audit committee member who has working experience as an accountant (ACPI)	134 (61%)	132 (60%)
The presence of at least one AC member who has working experience as an accountant (ACPACT)	197 (89%)	205 (93%)
The Chairman of AC has working experience as an accountant (APACH)	75 (34%)	71 (32%)
The presence of family member director on AC (ACFAM)	57 (26%)	55 (25%)
The convening of meeting between AC independent director with auditor without executives presence (MTEXT)	155 (70%)	155 (70%)
AC is authorised to report breach of rules to the Exchange (RBRE)	76 (34%)	79 (35%)

Figures in bracket represent the percentage of firms to total sample size of 221

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Also, there had been a growth in the number of firms with greater than 50% of INED on their AC. This could imply an improvement in the firms 'corporate governance practice (see Sommer, 1991), due to greater awareness of audit committees' important role in governing firms' financial reporting practice and internal control (see Abbott et al., 2004, BRC, 1999; Klein 2002) and protecting shareholders' interests in the presence of controlling owner-managers on the board of firms (see Jaggi and Leung, 2007). In addition, Table 6.26 presents the descriptive statistics of audit committee independence variables. Moreover, Tables 6.28 and 6.29 present the correlation analysis of audit committee independence variables. The correlation amongst audit committee independence variables is low (i.e. r less than 0.5)

Table 6.26: Descriptive Statistics Analysis of Audit Committee Independence Variables (Yr 2002-2003)

(Note: AC = Audit Committee, INED = Independent director, AUDF = Wholly composed of AC by INED, AUGMJ = More than majority of AC members was INED, AUDMJ = Majority of AC members was INED, ACSIN = Senior INED was AC member, AXCEO = Exclusion of CEO, CFO and/or managing director from AC membership, ACPI = At least one independent AC's member has practical accountant experience, ACPACT = At least one AC member has practising accountant experience, APACH = AC's chairman has practising accountant experience, ACFAM = The presence of family-member director in AC, MTEXT = The convening of separate meeting between AC members and external auditor without an executive member, RBRE = The transparency of the AC's authority to report to the MBSB the firm's breach of MBSB listing rulings where a firm's board has not appropriately resolved the matter raised by the AC.

Audit Committee Independence Variables (Year 2002)											
Descrp. Stat	AUDF	AUGMJ	AUDMJ	ACSIN	AXCEO	ACPI	ACPACT	APACH	ACFAM	MTEXT	RBRE
Max	1	1	1	1	1	1	1	1	1	1	1
Min	0	0	0	0	0	0	0	0	0	0	0
Mean	0.0995	0.9140	0.9367	0.3982	0.8552	0.6878	0.8959	0.3394	0.2579	0.7014	0.3439
Median	0.000	1	1	0.000	1	1	1	0	0	1	0
Std Dev	0.3008	0.2810	2.4414	0.4906	0.3527	0.6233	0.3060	0.4746	0.4385	0.4587	0.4761
Skewness	2.693	-2.974	-3.610	0.419	-2.033	0.45	-2.611	0.683	1.114	-0.886	0.662
Kurtosis	5.302	6.908	11.131	-1.841	2.151	-0.051	4.861	-1.547	-0.765	-1.226	-1.576
Sum	22	202	207	88	189	152	198	75	57	155	76
Audit Committee Independence Variables (Year 2003)											
Descrp. Stat	AUDF	AUDMJ	AUDMJ	ACSIN	AXCEO	ACPI	ACPACT	APACH	ACFAM	MTEXT	RBRE
Max	1	1	1	1	1	1	1	1	1	1	1
Min	0	0	0	0	0	0	0	0	0	0	0
Mean	0.0905	0.9367	0.9910	0.4208	0.9683	0.6833	0.9276	0.3213	0.2489	0.7014	0.3575
Median	0.00	1	1	0.00	1	1	1	0.00	0	1	0
Std Dev	0.2875	2.4414	0.0949	0.4948	0.1753	0.6390	0.2597	0.468	0.4333	0.4587	0.4803
Skewness	2.874	-3.610	-10.440	-5	-5.385	0.604	-3.323	0.771	1.170	-0.886	0.599
Kurtosis	6.319	11.131	107.963	23.21	27.24	0.412	9.123	-1.419	-6.38	-1.226	-1.656
Sum	20	207	219	93	214	160	205	71	55	155	79
<i>N</i> = 221 firms											

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Table 6.27: Distribution of INED, NED and ED on the Audit Committee (Yr 2002-2003)

(Note: INED = Independent Director, NED = Non-Executive director, ED = Executive Director)

Proportion of Directors	Types of Director					
	Yr 2002			Yr 2003		
	INED	NED	ED	INED	NED	ED
Less than 50%	13	25	221	3	220	220
50%	7	0	0	6	0	0
Greater than 50% but less than 2/3	116	6	0	130	1	1
2/3 and higher but less 100%	63	0	0	62	0	0
100%	22	0	0	20	0	0
Max	44	2	2	4	3	2
Min	1	0	0	1	0	0
Mean	2.4571	0.4570	0.6471	2.4977	0.3891	0.6697
Median	2	0	1	2	0	1
Size of Audit Committee						
	<u>2002</u>	<u>2003</u>				
Max	6	7				
Min	3	2				
Mean	3.5792	3.5566				
Median	3	3				
Structure of Audit Committee						
	Yr 2002			Yr 2003		
	INED	NED	ED	INED	NED	ED
i. Chairman of AC	121	0	0	121	0	0
ii. The presence of firm's CEO/MD, Finance Director, CFO and/or Financial Controller	Respectively in 2002 and 2003 there were 32 and 7 of the respective executives on the audit committee.					

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Table 6.28: Spearman's Correlation Analysis of Audit Committee Independence's Variables (Year 2002) [2-tailed test]

(Note: AC = Audit Committee, INED = Independent director, AUDF = Wholly composed of AC by INED, AUGMJ = More than majority of AC members was INED, AUDMJ = Majority of AC members was INED, ACSIN = Senior INED was AC member, ACPI = At least one independent AC member has practising accountant experience, ACPACT = At least one AC's members has practising accountant experience, APACH = AC's chairman has practising accountant experience, AXCEO = Exclusion of CEO, CFO and/or managing director from AC membership, ACFAM = The presence of family-member director on AC, MTEXT = The convening of separate meeting between AC members and external auditor without executive member presence, RBRE = The transparency of AC's authority to report to the MBSB the firm's breach of MBSB listing rulings where the firm's board has not appropriately resolved the matter raised by the AC, 02 = Year 2002, Figures in Italics represent the p-value of the variables' correlation).

Variables	AUDF02	AUDMJ02	AUGMJ02	ACSIN02	ACPI02	ACPACT02	APACH02	AXCEO02	ACFAM02	MTEXT02	RBRE02
AUDF02	1.0000	0.0865	0.1020	0.0074	0.1319	-0.0352	0.0170	0.1368	-0.1960	-0.0802	-0.0498
		<i>0.2003</i>	<i>0.1307</i>	<i>0.9128</i>	<i>0.0502</i>	<i>0.6031</i>	<i>0.8011</i>	<i>0.0422</i>	<i>0.0034</i>	<i>0.2348</i>	<i>0.4613</i>
AUDMJ02	0.0865	1.0000	0.8480	0.0598	0.2070	0.2764	0.1079	0.1041	-0.0165	-0.0073	0.0319
	<i>0.2003</i>		<i>0.0000</i>	<i>0.3767</i>	<i>0.0020</i>	<i>0.0000</i>	<i>0.1096</i>	<i>0.1227</i>	<i>0.8070</i>	<i>0.9135</i>	<i>0.6377</i>
AUGMJ02	0.1020	0.8480	1.0000	0.0187	0.1982	0.2126	0.0835	0.1490	-0.0037	-0.0238	0.0181
	<i>0.1307</i>	<i>0.0000</i>		<i>0.7828</i>	<i>0.0031</i>	<i>0.0015</i>	<i>0.2166</i>	<i>0.0267</i>	<i>0.9567</i>	<i>0.7252</i>	<i>0.7885</i>
ACSIN02	0.0074	0.0598	0.0187	1.0000	0.0689	0.0351	-0.0169	-0.0330	0.0275	0.0259	0.0727
	<i>0.9128</i>	<i>0.3767</i>	<i>0.7828</i>		<i>0.3076</i>	<i>0.6041</i>	<i>0.8030</i>	<i>0.6252</i>	<i>0.6840</i>	<i>0.7022</i>	<i>0.2817</i>
ACPI02	0.1319	0.2070	0.1982	0.0689	1.0000	0.4026	0.5999	-0.0287	0.1252	-0.0169	0.1041
	<i>0.0502</i>	<i>0.0020</i>	<i>0.0031</i>	<i>0.3076</i>		<i>0.0000</i>	<i>0.0000</i>	<i>0.6715</i>	<i>0.0632</i>	<i>0.8026</i>	<i>0.1230</i>
ACPACT02	-0.0352	0.2764	0.2126	0.0351	0.4026	1.0000	0.2443	-0.0139	-0.0362	-0.0605	0.1532
	<i>0.6031</i>	<i>0.0000</i>	<i>0.0015</i>	<i>0.6041</i>	<i>0.0000</i>		<i>0.0002</i>	<i>0.8371</i>	<i>0.5928</i>	<i>0.3707</i>	<i>0.0228</i>
APACH02	0.0170	0.1079	0.0835	-0.0169	0.5999	0.2443	1.0000	-0.0581	0.1891	0.0710	0.0847
	<i>0.8011</i>	<i>0.1096</i>	<i>0.2166</i>	<i>0.8030</i>	<i>0.0000</i>	<i>0.0002</i>		<i>0.3899</i>	<i>0.0048</i>	<i>0.2936</i>	<i>0.2100</i>
AXCEO	0.1368	0.1041	0.1490	-0.0330	-0.0287	-0.0139	-0.0581	1.0000	-0.1101	-0.1561	-0.0540
	<i>0.0422</i>	<i>0.1227</i>	<i>0.0267</i>	<i>0.6252</i>	<i>0.6715</i>	<i>0.8371</i>	<i>0.3899</i>		<i>0.1025</i>	<i>0.0202</i>	<i>0.4242</i>
ACFAM02	-0.1960	-0.0165	-0.0037	0.0275	0.1252	-0.0362	0.1891	-0.1101	1.0000	0.0457	-0.0131
	<i>0.0034</i>	<i>0.8070</i>	<i>0.9567</i>	<i>0.6840</i>	<i>0.0632</i>	<i>0.5928</i>	<i>0.0048</i>	<i>0.1025</i>		<i>0.4990</i>	<i>0.8464</i>
MTEXT02	-0.0802	-0.0073	-0.0238	0.0259	-0.0169	-0.0605	0.0710	-0.1561	0.0457	1.0000	0.3059
	<i>0.2348</i>	<i>0.9135</i>	<i>0.7252</i>	<i>0.7022</i>	<i>0.8026</i>	<i>0.3707</i>	<i>0.2936</i>	<i>0.0202</i>	<i>0.4990</i>		<i>0.0000</i>
RBRE02	-0.0498	0.0319	0.0181	0.0727	0.1041	0.1532	0.0847	-0.0540	-0.0131	0.3059	1.0000
	<i>0.4613</i>	<i>0.6377</i>	<i>0.7885</i>	<i>0.2817</i>	<i>0.1230</i>	<i>0.0228</i>	<i>0.2100</i>	<i>0.4242</i>	<i>0.8464</i>	<i>0.0000</i>	

Table 6.29: Spearman's Correlation Analysis of Audit Committee Independence's Variables (Year 2003) [2-tailed test]

(Note: AC = Audit Committee, INED = Independent director, AUDF = Wholly composed of AC by INED, AUGMJ = More than majority of AC members was INED, AUDMJ = Majority of AC members was INED, ACSIN = Senior INED was AC member, ACPI = At least one independent AC member has practising accountant experience, ACPACT = At least one AC's members has practising accountant experience, APACH = AC's chairman has practising accountant experience, AXCEO = Exclusion of CEO, CFO and/or managing director from AC membership, ACFAM = The presence of family-member director on AC, MTEXT = The convening of separate meeting between AC members and external auditor without executive member presence, RBRE = The transparency of AC's authority to report to the MBSB the firm's breach of MBSB listing rulings where the firm's board has not appropriately resolved the matter raised by the AC, 03 = Year 2003, Figures in Italics represent the p-value of the variables' correlation).

Variables	AUDF03	AUDMJ03	AUGMJ03	ACSIN03	ACPI03	ACPACT03	APACH03	AXCEO03	ACFAM03	MTEXT03	RBRE03
AUDF03	1.0000	0.0301	0.0611	-0.0772	0.1480	-0.0945	0.0194	0.0571	-0.1451	-0.0009	-0.0707
		<i>0.6558</i>	<i>0.3657</i>	<i>0.2531</i>	<i>0.0278</i>	<i>0.1617</i>	<i>0.7742</i>	<i>0.3987</i>	<i>0.0311</i>	<i>0.9890</i>	<i>0.2952</i>
AUDMJ03	0.0301	1.0000	0.4931	0.0815	0.0256	0.1577	-0.0366	-0.0173	0.0550	0.0420	-0.0284
	<i>0.6558</i>		<i>0.0000</i>	<i>0.2278</i>	<i>0.7052</i>	<i>0.0190</i>	<i>0.5886</i>	<i>0.7983</i>	<i>0.4158</i>	<i>0.5341</i>	<i>0.6743</i>
AUGMJ03	0.0611	0.4931	1.0000	-0.0311	-0.0344	0.0393	0.0296	-0.0351	-0.1126	0.0323	0.0435
	<i>0.3657</i>	<i>0.0000</i>		<i>0.6458</i>	<i>0.6105</i>	<i>0.5608</i>	<i>0.6619</i>	<i>0.6043</i>	<i>0.0951</i>	<i>0.6326</i>	<i>0.5204</i>
ACSIN03	-0.0772	0.0815	-0.0311	1.0000	0.0010	0.1320	-0.0761	0.1018	0.0605	0.0555	0.0909
	<i>0.2531</i>	<i>0.2278</i>	<i>0.6458</i>		<i>0.9886</i>	<i>0.0500</i>	<i>0.2599</i>	<i>0.1313</i>	<i>0.3705</i>	<i>0.4112</i>	<i>0.1779</i>
ACPI03	0.1480	0.0256	-0.0344	0.0010	1.0000	0.3237	0.5790	0.0714	0.1144	0.0689	0.0883
	<i>0.0278</i>	<i>0.7052</i>	<i>0.6105</i>	<i>0.9886</i>		<i>0.0000</i>	<i>0.0000</i>	<i>0.2903</i>	<i>0.0898</i>	<i>0.3078</i>	<i>0.1911</i>
ACPACT03	-0.0945	0.1577	0.0393	0.1320	0.3237	1.0000	0.1922	-0.0505	-0.0007	0.0466	0.1355
	<i>0.1617</i>	<i>0.0190</i>	<i>0.5608</i>	<i>0.0500</i>	<i>0.0000</i>		<i>0.0041</i>	<i>0.4548</i>	<i>0.9914</i>	<i>0.4906</i>	<i>0.0442</i>
APACH03	0.0194	-0.0366	0.0296	-0.0761	0.5790	0.1922	1.0000	0.0138	0.0746	0.0467	0.1541
	<i>0.7742</i>	<i>0.5886</i>	<i>0.6619</i>	<i>0.2599</i>	<i>0.0000</i>	<i>0.0041</i>		<i>0.8387</i>	<i>0.2692</i>	<i>0.4902</i>	<i>0.0220</i>
AXCEO03	0.0571	-0.0173	-0.0351	0.1018	0.0714	-0.0505	0.0138	1.0000	0.0443	0.0513	0.0271
	<i>0.3987</i>	<i>0.7983</i>	<i>0.6043</i>	<i>0.1313</i>	<i>0.2903</i>	<i>0.4548</i>	<i>0.8387</i>		<i>0.5119</i>	<i>0.4476</i>	<i>0.6889</i>
ACFAM03	-0.1451	0.0550	-0.1126	0.0605	0.1144	-0.0007	0.0746	0.0443	1.0000	0.0555	-0.0799
	<i>0.0311</i>	<i>0.4158</i>	<i>0.0951</i>	<i>0.3705</i>	<i>0.0898</i>	<i>0.9914</i>	<i>0.2692</i>	<i>0.5119</i>		<i>0.4120</i>	<i>0.2366</i>
MTEXT03	-0.0009	0.0420	0.0323	0.0555	0.0689	0.0466	0.0467	0.0513	0.0555	1.0000	0.2598
	<i>0.9890</i>	<i>0.5341</i>	<i>0.6326</i>	<i>0.4112</i>	<i>0.3078</i>	<i>0.4906</i>	<i>0.4902</i>	<i>0.4476</i>	<i>0.4120</i>		<i>0.0001</i>
RBRE03	-0.0707	-0.0284	0.0435	0.0909	0.0883	0.1355	0.1541	0.0271	-0.0799	0.2598	1.0000
	<i>0.2952</i>	<i>0.6743</i>	<i>0.5204</i>	<i>0.1779</i>	<i>0.1911</i>	<i>0.0442</i>	<i>0.0220</i>	<i>0.6889</i>	<i>0.2366</i>	<i>0.0001</i>	

(II) *Audit Committee's Leadership and Variables Characteristics*

The MBSB listing rulings (see Para 15.10) require companies to appoint their audit committee's chairman from amongst their independent director members. As shown in Table 6.30, more than 30% of the companies in the sample had extended the quality of the independence of their AC chairman by appointing an experienced independent director (i.e. senior independent director) to the chairmanship position. In addition, the number of audit committee chairman with accounting and finance knowledge and experience had also increased (see Table 6.31). Given that the committee's chairman has greater authorities than other committee members (namely, having the second casting vote at the committee's meeting and in the appointment of committee members, and having direct contact with the board's chairman and top management executive)⁶⁰, his/her corporate governance experience and accounting knowledge and skills will be valuable in providing effective leadership to audit committee members and enhancing the credibility of firm's financial reporting practice.

Table 6.30: Audit Committee Leadership Characteristics (Yr 2002-2003)

Audit Committee Leadership Characteristics	Frequency (N = 221 Firms)	
	Yr 2002	Yr 2003
Audit Committee Chairman is Senior Independent Director (ACHSIN)	68 (31%)	71 (32%)
Audit Committee Chairman has accounting and finance Knowledge and Experience (ACHACF)	112 (51%)	125 (57%)
Audit Committee Chairman has business and/or management related knowledge and experience (ACHBUS)	34 (15%)	38 (17%)
Audit Committee Chairman with accounting and finance knowledge but has no working experience as accountant (ACHOAF)	43 (19%)	58 (26%)
Audit Committee Chairman who has worked as accountant (ACHP)	75 (34%)	71 (32%)
The senior independent audit committee chairman has working experience as accountant (ACHSINP)	23 (10%)	18 (8%)

Figures in brackets represent the percentage of firms

⁶⁰ This information was gathered from the sampled companies Audit Committee Report

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**Table 6.31: Descriptive Statistics Analysis of Audit Committee Leadership Variables
(Yr 2002-2003)**

(Note: AC = Audit Committee, ACHSIN = AC's chairman is senior independent director, ACHACF = AC's chairman possesses accounting and finance knowledge and skills, ACHBUS = AC's chairman has business/management related knowledge and experience, ACHP = AC's chairman has practising accountant experience, ACHSINP = AC's chairman is senior independent director who has practising accountant experience)

Audit Committee Leadership Variables (Yr 2002)					
Descrp. Stat.	ACHSIN02	ACHACF02	ACHBUS02	ACHP02	ACHSIP02
Mean	0.3077	0.5068	0.1538	0.3394	0.1041
Median	0.0000	1.0000	0.0000	0.0000	0.0000
Std. Dev.	0.4626	0.5011	0.3616	0.4746	0.3060
Skewness	0.8390	-0.0273	1.9319	0.6831	2.6110
Kurtosis	-1.3079	-2.0176	1.7481	-1.5474	4.8612
Minimum	0	0	0	0	0
Maximum	1	1	1	1	1
Sum	68	112	34	75	23
Audit Committee Leadership Variables (Yr 2003)					
Descrp. Stat	ACHSIN03	ACHACF03	ACHBUS03	ACHP03	ACHSIP03
Mean	0.3213	0.5656	0.1719	0.3213	0.0814
Median	0.0000	1.0000	0.0000	0.0000	0.0000
Std. Dev.	0.4680	0.4968	0.3782	0.4680	0.2741
Skewness	0.7708	-0.2665	1.7507	0.7708	3.0814
Kurtosis	-1.4189	-1.9467	1.0746	-1.4189	7.5635
Minimum	0	0	0	0	0
Maximum	1	1	1	1	1
Sum	71	125	38	71	18

Table 6.32 presents the correlation analysis of audit committee leadership variables. The analysis indicated a low correlation amongst audit committee leadership variables (i.e. r less than 0.6)

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Table 6.32: Spearman's Correlation Analysis of Audit Committee Leadership Variables (Yr 2002-2003) [2-tailed test]

(Note: AC = Audit Committee, ACHSIN = AC's chairman is senior independent director, ACHACF = AC's chairman possesses accounting and finance knowledge and skills, ACHBUS = AC's chairman has business/management related knowledge and experience, ACHP = AC's chairman has practising accountant experience, ACHSINP = AC's chairman is senior independent director who has practising accountant experience. 02 = Year 2002. 03 = Year 2003, Figures in Italics represent the p-value of the variables' correlation)

Variables	ACHSIN02	ACHACF02	ACHBUS02	ACHP02	ACHSIP02
ACHSIN02	1.0000	-0.0287	0.0690	-0.0016	0.5112
		<i>0.6718</i>	<i>0.3073</i>	<i>0.9812</i>	<i>0.0000</i>
ACHACF02	-0.0287	1.0000	-0.4322	0.5924	0.2769
	<i>0.6718</i>		<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>
ACHBUS02	0.0690	-0.4322	1.0000	-0.2791	-0.1453
	<i>0.3073</i>	<i>0.0000</i>		<i>0.0000</i>	<i>0.0308</i>
ACHP02	-0.0016	0.5924	-0.2791	1.0000	0.4755
	<i>0.9812</i>	<i>0.0000</i>	<i>0.0000</i>		<i>0.0000</i>
ACHSIP02	0.5112	0.2769	-0.1453	0.4755	1.0000
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0308</i>	<i>0.0000</i>	
Variables	ACHSIN03	ACHACF03	ACHBUS03	ACHP03	ACHSIP03
ACHSIN03	1.0000	-0.0813	0.0974	-0.0998	0.4328
		<i>0.2287</i>	<i>0.1491</i>	<i>0.1391</i>	<i>0.0000</i>
ACHACF03	-0.0813	1.0000	-0.5200	0.5247	0.2276
	<i>0.2287</i>		<i>0.0000</i>	<i>0.0000</i>	<i>0.0007</i>
ACHBUS03	0.0974	-0.5200	1.0000	-0.2621	-0.0919
	<i>0.1491</i>	<i>0.0000</i>		<i>0.0001</i>	<i>0.1736</i>
ACHP03	-0.0998	0.5247	-0.2621	1.0000	0.4328
	<i>0.1391</i>	<i>0.0000</i>	<i>0.0001</i>		<i>0.0000</i>
ACHSIP03	0.4328	0.2276	-0.0919	0.4328	1.0000
	<i>0.0000</i>	<i>0.0007</i>	<i>0.1736</i>	<i>0.0000</i>	

(III) ***Audit Committee Competency and Variables Characteristics***

Specifically, audit committee members' knowledge and experience in accounting and finance are critical when evaluating the firm's financial and auditing process (DeZoort, 1998; Tan and Kao, 1999). The results in Table 6.33 indicate that, listed firms in Malaysia were becoming increasingly aware of the importance of financial experts in accounting and finance on their audit committee. On the other hand, the MBSB's specific requirements for a qualified financial expert to be appointed in the firm's AC also influenced the increase in the employment of director with accounting and finance experience. The results presented in Table 6.33 also show a mix of skills amongst audit

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committee composition (i.e. business, law and secretarial background). Table 6.34 presents the descriptive statistics of the proportion of audit committee member with accounting and finance knowledge (AUACF), practising accountant experience (APACT), business/management related knowledge and experience (see Abbott et al., 2006), law background and company secretary experience (ACSEC).

Table 6.33: Range of Knowledge and Skills of Audit Committee Members (Yr 2002, 2003)

Number of AC Members with Accounting and Finance Knowledge and Skills (AUACF)							
	No of persons	1	2	3	4	5	Total
Freq (N = 221 firms)	Year 2002	85	88	28	10	1	202
	2003	75	90	47	6	1	219
Number of AC Members who are accounting practitioners (APACT)							
	No of persons	1	2	3	4	Total	
Freq (N = 221 firms)	Year 2002	157	38	3	0	198	
	2003	161	39	3	2	205	
Number of AC Members with business and/or management related knowledge and experience (ACBUS)							
	No of persons	1	2	3	Total		
Freq (N = 221 firms)	Year 2002	72	17	3	92		
	2003	94	30	1	125		
Number of AC Members with law qualification (ACLAW)							
	No of persons	1	2	3	Total		
Freq (N = 221 firms)	Year 2002	64	11	1	76		
	2003	60	10	0	70		
Number of AC Members with chartered secretarial and administrator qualification (ACSEC)							
	No of persons	1	Total				
Freq (N = 221 firms)	Year 2002	6	6				
	2003	10	10				

Variables were subsequently transformed to normal scores to be consistent with the dependent variable measurement and assist interpretation of hypothesis testing of the impact of audit committee competencies on firm performance (see Table 6.35). Table 6.36 reports the correlation analysis of audit committee competency variables. The correlation amongst audit committee variables was low (i.e. r less than 0.5)

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Table 6.34: Descriptive Statistics of Audit Committee Knowledge & Skills Variables (Yr 2002, 2003) [AC = Audit Committee, AUACF = Proportion of AC members with accounting and finance knowledge, APACT= Proportion of AC members with practising accountant experience, ACBUS = Proportion of AC members with business/management related knowledge and experience , ACLAW = Proportion of AC members with law background, ACSEC = Proportion of AC members with company secretary experience ACSEC, N = 221 firms].

Audit Committee Knowledge & Skills Variables (Yr 2002)					
Descrip. Stat	AUACF	APACT	ACBUS	ACLAW	ACSEC
Mean	0.4973	0.3144	0.1461	0.1133	0.0180
Median	0.5000	0.3333	0.0000	0.0000	0.0000
Std. Dev.	0.2374	0.1689	0.1967	0.1757	0.0746
Skewness	0.2292	0.3316	1.2476	1.6029	4.1994
Kurtosis	-0.2877	0.4088	1.3075	2.9570	17.2056
Min	0.0000	0.0000	0.0000	0.0000	0.0000
Max	1.0000	0.6667	1.0000	1.0000	0.5000
Audit Committee Knowledge & Skills Variables (Yr 2003)					
Descrip. Stat	AUACF	APACT	ACBUS	ACLAW	ACSEC
Mean	0.5458	0.3329	0.1996	0.1014	0.0130
Median	0.5000	0.3333	0.2000	0.0000	0.0000
Std. Dev.	0.2275	0.1699	0.2074	0.1608	0.0606
Skewness	0.3030	0.7070	0.7162	1.3455	4.6079
Kurtosis	-0.6098	1.4200	-0.3297	0.9153	19.9736
Min	0.0000	0.0000	0.0000	0.0000	0.0000
Max	1.0000	1.0000	0.6667	0.6667	0.3333

Table 6.35: Descriptive Statistics of the Normal Scores of Audit Committee Competency Variables (Yr 2002, 2003) [AC = Audit Committee, NAUACF = Normal scores of proportion of AC members with accounting and finance knowledge, NAPACT= Normal scores of proportion of AC members with practising accountant experience, NACBUS = Normal scores of proportion of AC members with business/management related knowledge and experience, NACLAW = Normal scores of proportion of AC members with law background, NACSEC = Normal scores of proportion of AC members with company secretary experience ACSEC, N= 221 firms].

Audit Committee Knowledge & Skills Variables (Yr 2002)					
Descrip. Stat	NAUACF02	NAPACT02	NACBUS02	NACLAW02	NACSEC02
Mean	-0.0034	-0.0026	0.0613	0.0678	0.0435
Median	0.0395	0.3038	-0.5452	-0.4431	-0.0735
Std. Dev.	0.9389	0.9092	0.7925	0.7619	0.4734
Skewness	-0.0500	-0.0085	0.9352	1.1556	1.9019
Kurtosis	-0.4333	-0.5782	-0.2748	0.1323	6.7647
Min	-2.0042	-1.6068	-0.5452	-0.4431	-0.0735
Max	1.7709	1.6276	2.6117	2.6117	2.6117
Audit Committee Knowledge & Skills Variables (Yr 2003)					
Descrip. Stat	NAUACF03	NAPACT03	NACBUS03	NACLAW03	NACSEC03
Mean	-0.0028	-0.0008	0.0413	0.0684	0.0368
Median	-0.1018	0.2162	-0.0678	-0.4061	-0.0565
Std. Dev.	0.9368	0.9243	0.8362	0.7450	0.4320
Skewness	-0.0806	0.0480	0.5319	1.2352	1.4814
Kurtosis	-0.3899	-0.1783	-0.9106	0.2663	7.4833
Min	-2.4699	-1.7709	-0.7774	-0.4061	-0.0565
Max	1.6716	2.6117	1.7444	2.3652	2.2111

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Table 6.36: Spearman's Correlation Analysis of Audit Committee Competency Variables (Yr 2002 and 2003) [2-tailed test]

(AC = Audit Committee, NAUACF = Normal scores of the proportion of AC members with accounting and finance knowledge, NAPACT= Normal scores of the proportion of AC members with practising accountant experience, NACBUS = Normal scores of the proportion of AC members with business/management related knowledge and experience, NACLAW = Normal scores of the proportion of AC members with law background, NACSEC = Normal scores of the proportion of AC members with company secretary experience ACSEC. Figures in Italics represent the p-value of the variables' correlation).

Variables	NAUACF02	NAPACT02	NACBUS02	NACLAW02	NACSEC02
NAUACF02	1.0000	0.4486	-0.2994	-0.1054	-0.0010
		<i>0.0000</i>	<i>0.0000</i>	<i>0.1181</i>	<i>0.9887</i>
NAPACT02	0.4486	1.0000	-0.1366	-0.1849	0.1093
	<i>0.0000</i>		<i>0.0425</i>	<i>0.0058</i>	<i>0.1051</i>
NACBUS02	-0.2994	-0.1366	1.0000	-0.0671	0.0179
	<i>0.0000</i>	<i>0.0425</i>		<i>0.3208</i>	<i>0.7912</i>
NACLAW02	-0.1054	-0.1849	-0.0671	1.0000	-0.1323
	<i>0.1181</i>	<i>0.0058</i>	<i>0.3208</i>		<i>0.0496</i>
NACSEC02	-0.0010	0.1093	0.0179	-0.1323	1.0000
	<i>0.9887</i>	<i>0.1051</i>	<i>0.7912</i>	<i>0.0496</i>	
Variables	NAUACF03	NAPACT03	NACBUS03	NACLAW03	NACSEC03
NAUACF03	1.0000	0.3448	-0.4142	-0.1125	0.0969
		<i>0.0000</i>	<i>0.0000</i>	<i>0.0954</i>	<i>0.1509</i>
NAPACT03	0.3448	1.0000	-0.0975	-0.1423	-0.0641
	<i>0.0000</i>		<i>0.1487</i>	<i>0.0345</i>	<i>0.3426</i>
NACBUS03	-0.4142	-0.0975	1.0000	-0.0335	0.0141
	<i>0.0000</i>	<i>0.1487</i>		<i>0.6207</i>	<i>0.8350</i>
NACLAW03	-0.1125	-0.1423	-0.0335	1.0000	0.0012
	<i>0.0954</i>	<i>0.0345</i>	<i>0.6207</i>		<i>0.9856</i>
NACSEC03	0.0969	-0.0641	0.0141	0.0012	1.0000
	<i>0.1509</i>	<i>0.3426</i>	<i>0.8350</i>	<i>0.9856</i>	

6.5.2.3 Nomination Committee Corporate Governance Variables

In terms of the establishment of a nomination committee in the 221 sampled firms, more than 82% of the companies had set up a nomination committee⁶¹ (see Table 6.37). Further, most of the companies with nomination committee had a high proportion of independent directors on the committee and this practice had extended with the increased appointment of independent director as chairman of the committee. In addition, the presence of a dominating figure such as the CEO, CFO managing director and Executive Board Chairman on the nomination committee had been reduced

⁶¹ Respectively in 2002 and 2003, 41 and 40 companies have not yet formed Nomination Committee

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in 2003. The increase in companies' pursuits of establishing appropriate governance at board level may have indicated their support and commitment of practising good corporate governance. Further, when such pursuit is appropriately and continually practised in the long term, it will ensure a fair and objective selection of prospective board members (Shivdasani and Yermack, 1996), effective assessment of current board members' contribution, appointment of competent directors, and better organisation of the firm's human resources and skills (Gregory, 2001; Vafeas, 1999). Table 6.38 presents the descriptive statistics of nomination committee corporate governance variable.

**Table 6.37: Distribution of INED, NED and ED on the Nomination Committee (NC)
(Yr 2002-2003)**

(Note: INED = Independent Director, NED = Non-Executive director, ED = Executive Director)

Proportion of Directors	Types of Director					
	Yr 2002			Yr 2003		
	INED	NED	ED	INED	NED	ED
Less than 1/3	4	83	169	2	105	167
1/3	7	78	9	5	62	11
Greater than 1/3 but less than 50%	0	5	0	3	3	0
50% but less than 100%	111	11	2	103	9	3
100%	58	3	0	68	2	0
Max	4	3	2	4	3	2
Min	0	0	0	0	0	0
Mean	2.3073	0.7333	2.3297	2.3297	0.6022	0.1484
Median	2	1	2	2	1	0
Size of Nomination Committee						
	<u>2002</u>	<u>2003</u>				
Max	6	6				
Min	2	2				
Mean	3.1167	3.1381				
Median	3	3				
Structure of Nomination Committee						
	Yr 2002			Yr 2003		
	INED	NED	ED	INED	NED	ED
i. Chairman of NC	134	45	1	143	36	2
ii. The presence of CEO, CFO, MD and or Executive Board Chairman on NC	Respectively in 2002 and 2003 there were 10 and 8 of the respective executives on the NC.					

Table 6.38: Descriptive Statistics of Nomination Committee Corporate Governance Variables for the Year 2002 and 2003

(Note: NC = Nomination Committee, NCEXIST = The establishment of nomination committee (NC) in the company, NCINED = Proportion of INED on the NC, NNCINED = Normal scores of the proportion of INED on the NC, NCEXCEO = The absence of CEO on nomination committee composition, NCFAM = The presence of family member on NC, NCHINED = The appointment of independent director as the Chairman of NC, NCHSINED = The appointment of Senior independent director as NC chairman, NCSINED = The presence of Senior independent director on NC)

Descrip. Stat.	Nomination Committee Corporate Governance Variable 2002							
	NCEXIST	NCINED	NCEXCEO	NNCFAM	NCHINED	NCHSINED	NCSINED	NNCINED
Mean	0.8190	0.6127	0.7964	0.0905	0.5882	0.1403	0.3258	-0.0082
Std Dev.	0.3859	0.3460	0.4036	0.2875	0.4933	0.3481	0.4697	0.8457
Skewness	-1.668	-0.735	-1.482	2.874	-0.361	2.086	0.749	-0.1050
Kurtosis	0.791	-0.610	0.198	6.319	-1.887	2.373	-1.453	-1.1150
Min	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-1.2867
Max	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.1024
Sum	181	135.42	176	20	130	31	72	-1.8192
Descrip. Stat.	Nomination Committee Corporate Governance Variable 2003							
	NCEXIST	NCINED	NCEXCEO	NNCFAM	NCHINED	NCHSINED	NCSINED	NNCINED
Mean	0.8371	0.6167	0.8047	0.0995	0.6742	0.1493	0.3484	-0.0111
Std Dev.	0.3701	0.3568	0.3974	0.3149	0.4697	0.3572	0.4776	0.8383
Skewness	-1.838	-0.704	-1.548	3.125	-0.749	1.981	0.641	-0.1382
Kurtosis	1.392	-0.740	0.399	9.417	-1.453	1.943	-1.604	-1.2154
Min	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-1.2613
Max	1.00	1.00	1.00	2.00	1.00	1.00	1.00	1.0326
Sum	185	136.30	173	22	149	33	77	-2.4596
N = 221 firms								

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Table 6.39 identifies the correlation amongst nomination committee corporate governance variables.

The correlation between nomination committee composition and structure variables was low (i.e. r less than 0.7)

Table 6.39: Spearman's Correlation Analysis of Nomination Committee Corporate Governance Variables (Yr 2002-2003) [2-tailed test]

(Note: NCEXIST = The establishment of nomination committee (NC) in the company, NNCINED = Normal scores of the proportion of INED on the NC, NCEXCEO = The absence of CEO in nomination committee composition, NCFAM = The presence of family member on NC, NCHINED = The appointment of independent director as the Chairman of NC, NCHSINED = The appointment of Senior independent director as NC chairman, NCSINED = The presence of Senior independent director in NC, 02 = Year 2002, 03 = year 2003, Figures in Italics represent p-value of the variables' correlation)

Variables	NCEXIS02	NNCINED02	NCXCEO02	NCFAM02	NCHIN02	NCHSIN02	NCSIN02
NCEXIS02	1.0000	0.6589	0.8713	0.1073	0.5380	0.1899	0.3268
		<i>0.0000</i>	<i>0.0000</i>	<i>0.1116</i>	<i>0.0000</i>	<i>0.0046</i>	<i>0.0000</i>
NNCINED02	0.6589	1.0000	0.6479	0.0374	0.6332	0.1068	0.2862
	<i>0.0000</i>		<i>0.0000</i>	<i>0.5802</i>	<i>0.0000</i>	<i>0.1135</i>	<i>0.0000</i>
NCXCEO02	0.8713	0.6479	1.0000	0.1203	0.4902	0.1719	0.3275
	<i>0.0000</i>	<i>0.0000</i>		<i>0.0742</i>	<i>0.0000</i>	<i>0.0105</i>	<i>0.0000</i>
NCFAM02	0.1073	0.0374	0.1203	1.0000	-0.0566	0.0543	-0.0510
	<i>0.1116</i>	<i>0.5802</i>	<i>0.0742</i>		<i>0.4028</i>	<i>0.4222</i>	<i>0.4505</i>
NCHIN02	0.5380	0.6332	0.4902	-0.0566	1.0000	0.2585	0.2873
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.4028</i>		<i>0.0001</i>	<i>0.0000</i>
NCHSIN02	0.1899	0.1068	0.1719	0.0543	0.2585	1.0000	0.5811
	<i>0.0046</i>	<i>0.1135</i>	<i>0.0105</i>	<i>0.4222</i>	<i>0.0001</i>		<i>0.0000</i>
NCSIN02	0.3268	0.2862	0.3275	-0.0510	0.2873	0.5811	1.0000
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.4505</i>	<i>0.0000</i>	<i>0.0000</i>	
Variables	NCEXIS03	NNCINED03	NCXCEO03	NCFAM03	NCHIN03	NCHSIN03	NCSIN03
NCEXIS03	1.0000	0.6325	0.8375	0.1429	0.6346	0.1848	0.3226
		<i>0.0000</i>	<i>0.0000</i>	<i>0.0337</i>	<i>0.0000</i>	<i>0.0059</i>	<i>0.0000</i>
NNCINED03	0.6325	1.0000	0.6315	-0.0453	0.5827	0.2033	0.3164
	<i>0.0000</i>		<i>0.0000</i>	<i>0.5030</i>	<i>0.0000</i>	<i>0.0024</i>	<i>0.0000</i>
NCXCEO03	0.8375	0.6315	1.0000	0.0962	0.5002	0.1283	0.2470
	<i>0.0000</i>	<i>0.0000</i>		<i>0.1543</i>	<i>0.0000</i>	<i>0.0568</i>	<i>0.0002</i>
NCFAM03	0.1429	-0.0453	0.0962	1.0000	0.0614	0.0366	0.0854
	<i>0.0337</i>	<i>0.5030</i>	<i>0.1543</i>		<i>0.3639</i>	<i>0.5881</i>	<i>0.2059</i>
NCHIN03	0.6346	0.5827	0.5002	0.0614	1.0000	0.2642	0.2246
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.3639</i>		<i>0.0001</i>	<i>0.0008</i>
NCHSIN03	0.1848	0.2033	0.1283	0.0366	0.2642	1.0000	0.5729
	<i>0.0059</i>	<i>0.0024</i>	<i>0.0568</i>	<i>0.5881</i>	<i>0.0001</i>		<i>0.0000</i>
NCSIN03	0.3226	0.3164	0.2470	0.0854	0.2246	0.5729	1.0000
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0002</i>	<i>0.2059</i>	<i>0.0008</i>	<i>0.0000</i>	

6.5.2.4 **Remuneration Committee Corporate Governance Variables**

Similar to the practices found in relation to Nomination Committee, there had been an increase in the number of firms establishing a remuneration committee (RC) in their company (see Table 6.40). Result also indicated a higher presence of family member directors on the remuneration committee than nomination committee. Particularly in 2003, there had been a slight increase in the number of family director members on the remuneration committee. Nevertheless, the influence of family members on the remuneration committee was monitored by the high presence of independent directors on the committee. On average companies had more than a 50% presence of independent directors on the committee (see Table 6.40).

Moreover, many companies had appointed independent director as the RC chairman which further enhanced the objectivity and impartiality of remuneration committee judgements. Also the high proportion of independent directors and the appointment of an independent chairman to the remuneration committee would provide strong independent influence when the CEO or CFO is part of the committee member (see Table 6.41). Table 6.42 presents the correlation analysis of the corporate governance variables of the remuneration committee. The correlation amongst the remuneration committee variables was low (i.e. r less than 0.6).

Table 6.40: Descriptive Statistics of Remuneration Committee Corporate Governance Variables for the Year 2002 and 2003

(Note: The Table describes RCEXIST = The establishment of remuneration committee (RC) in the company, RCINED = The proportion of INED on the RC, NRCINED = The normal scores of proportion of INED on the RC RCEXCEO = The absence of CEO on the remuneration committee composition, RCFAM = The presence of family member on RC, RCHINED = The appointment of independent director as the Chairman of RC, RCHSINED = The appointment of Senior independent director as RC chairman, RCSINED = The presence of Senior independent director on RC)

Descrp. Stat.	Remuneration Committee Corporate Governance Variables 2002							
	RCEXIST	RCINED	RCEXCEO	RCFAM	RCHINED	RCHSINED	RCSINED	NRCINED
Mean	0.8326	0.5069	0.5566	0.2036	0.5928	0.1267	0.2941	0.0063
Std Dev.	0.3742	0.3100	0.4979	0.4147	0.4924	0.3334	0.4567	0.8829
Skewness	-1.794	-0.478	-0.229	1.673	-0.38	2.26	0.910	0.1287
Kurtosis	1.229	0.800	-1.965	1.383	-1.872	3.135	-1.183	-0.7609
Min	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-1.2489
Max	1.00	1.00	1.00	2.00	1.00	1.00	1.00	1.6492
Sum	184	112.2	123	45	131	28	65	1.3838
Descrp. Stat.	Remuneration Committee Corporate Governance Variables 2003							
	RCEXIST	RCINED	RCEXCEO	RCFAM	RCHINED	RCHSINED	RCSINED	NRCINED
Mean	0.8552	0.5456	0.5882	0.2489	0.6471	0.1538	0.3348	-0.0003
Std Dev.	0.3527	0.3123	0.4933	0.4538	0.4790	0.3616	0.4730	0.8784
Skewness	-2.033	-0.544	-0.361	1.461	-0.620	1.932	0.705	0.0302
Kurtosis	2.151	-0.599	-1.887	0.888	-1.631	1.748	-1.517	-0.8211
Min	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-1.3265
Max	1.00	1.00	1.00	2.00	1.00	1.00	1.00	1.4605
Sum	189	120.57	130	55	143	34	74	-0.0744
N = 221 firms								

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Table 6.41: The Distribution of INED, NED and ED on the Remuneration Committee (RC) [Yr 2002-2003]

(Note: INED = Independent Director, NED = Non-Executive director, ED = Executive Director)

Proportion of Directors	Types of Director					
	Yr 2002			Yr 2003		
	INED	NED	ED	INED	NED	ED
Less than 1/3	13	98	122	10	96	123
1/3	20	52	58	19	56	59
Greater than 1/3 but less than 50%	3	4	3	3	2	1
50% but less than 100%	126	22	0	122	17	3
100%	21	7	0	3	5	0
Max	4	4	2	4	4	2
Min	0	0	0	0	0	0
Mean	2	0.7923	0.4918	2.0321	0.6684	0.4886
Median	2	1	0	2	1	0
Size of Remuneration Committee						
	<u>2002</u>	<u>2003</u>				
Max	5	7				
Min	2	2				
Mean	3.2951	3.2043				
Median	3	3				
Structure of Remuneration Committee						
	Yr 2002			Yr 2003		
	INED	NED	ED	INED	NED	ED
i. Chairman of RC	131	46	6	139	37	10
ii. The presence of CEO, CFO, MD and or Executive Board Chairman in RC	Respectively in 2002 and 2003 there were 51 and 42 of the respective executives on the RC.					

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Table 6.42: Spearman's Correlation of Remuneration Committee Corporate Governance Variables (Yr 2002-2003) [2-tailed test]

(Note: The Table describes RCEXIST = The establishment of remuneration committee (RC) in the company, RCINED = The proportion of INED in the RC, NRCINED = The normal scores of proportion of INED in the RC RCEXCEO = The absence of CEO in the remuneration committee composition, RCFAM = The presence of family member in RC, RCHINED = The appointment of independent director as the Chairman of RC, RCHSINED = The appointment of Senior independent director as RC chairman, RCSINED = The presence of Senior independent director in RC. 02 = Year 2002, 03 = Year 2003. Figures in Italics represent p-value of the variables' correlation)

Variables	RCEXIS02	RCINED02	RCXCEO02	RCFAM02	RCHIN02	RCHSIN02	RCSIN02
RCEXIS02	1.0000	0.6309	0.5024	0.1933	0.5410	0.1708	0.2895
		<i>0.0000</i>	<i>0.0000</i>	<i>0.0039</i>	<i>0.0000</i>	<i>0.0110</i>	<i>0.0000</i>
RCINED02	0.6309	1.0000	0.3792	0.1333	0.6717	0.2213	0.2945
	<i>0.0000</i>		<i>0.0000</i>	<i>0.0479</i>	<i>0.0000</i>	<i>0.0009</i>	<i>0.0000</i>
RCXCEO02	0.5024	0.3792	1.0000	-0.1044	0.2056	0.0935	0.1364
	<i>0.0000</i>	<i>0.0000</i>		<i>0.1218</i>	<i>0.0021</i>	<i>0.1658</i>	<i>0.0428</i>
RCFAM02	0.1933	0.1333	-0.1044	1.0000	0.1331	0.0475	0.1237
	<i>0.0039</i>	<i>0.0479</i>	<i>0.1218</i>		<i>0.0481</i>	<i>0.4828</i>	<i>0.0664</i>
RCHIN02	0.5410	0.6717	0.2056	0.1331	1.0000	0.2603	0.2723
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0021</i>	<i>0.0481</i>		<i>0.0001</i>	<i>0.0000</i>
RCHSIN02	0.1708	0.2213	0.0935	0.0475	0.2603	1.0000	0.5901
	<i>0.0110</i>	<i>0.0009</i>	<i>0.1658</i>	<i>0.4828</i>	<i>0.0001</i>		<i>0.0000</i>
RCSIN02	0.2895	0.2945	0.1364	0.1237	0.2723	0.5901	1.0000
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0428</i>	<i>0.0664</i>	<i>0.0000</i>	<i>0.0000</i>	
Variables	RCEXIS03	RCINED03	RCXCEO03	RCFAM03	RCHIN03	RCHSIN03	RCSIN03
RCEXIS03	1.0000	0.6084	0.4918	0.2308	0.5302	0.1755	0.2919
		<i>0.0000</i>	<i>0.0000</i>	<i>0.0005</i>	<i>0.0000</i>	<i>0.0090</i>	<i>0.0000</i>
RCINED03	0.6084	1.0000	0.4264	0.0710	0.5902	0.1924	0.2968
	<i>0.0000</i>		<i>0.0000</i>	<i>0.2932</i>	<i>0.0000</i>	<i>0.0041</i>	<i>0.0000</i>
RCXCEO03	0.4918	0.4264	1.0000	-0.1700	0.2863	0.0255	0.1066
	<i>0.0000</i>	<i>0.0000</i>		<i>0.0114</i>	<i>0.0000</i>	<i>0.7064</i>	<i>0.1141</i>
RCFAM03	0.2308	0.0710	-0.1700	1.0000	0.1456	0.1096	0.1630
	<i>0.0005</i>	<i>0.2932</i>	<i>0.0114</i>		<i>0.0305</i>	<i>0.1041</i>	<i>0.0153</i>
RCHIN03	0.5302	0.5902	0.2863	0.1456	1.0000	0.2362	0.2030
	<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.0305</i>		<i>0.0004</i>	<i>0.0024</i>
RCHSIN03	0.1755	0.1924	0.0255	0.1096	0.2362	1.0000	0.6010
	<i>0.0090</i>	<i>0.0041</i>	<i>0.7064</i>	<i>0.1041</i>	<i>0.0004</i>		<i>0.0000</i>
RCSIN03	0.2919	0.2968	0.1066	0.1630	0.2030	0.6010	1.0000
	<i>0.0000</i>	<i>0.0000</i>	<i>0.1141</i>	<i>0.0153</i>	<i>0.0024</i>	<i>0.0000</i>	

6.5.3 Control Variables Characteristics

(1) *Descriptive Statistics of Control Variables*

In data analysis modelling, control variables are identified as “*the variables that are not changed throughout the trials in an experiment because the experimenter is not interested in the effect of that variable being changed for that particular experiment*” [Wikipedia (a)]. Specifically, they are extraneous factors that can possibly have an effect on observations, however, they are kept constant to minimise their impact on outcomes. Respectively, Tables 6.43 and 6.44 present the descriptive statistics of the research control variables before and after normal scores transformation. The total assets (ASET) represent Datastream item (02999AQ). In addition, debt to equity ratio (DEQ) was computed as total debt divided by common equity using Datastream items long term debt (wc03251), current liabilities (wc03101) and common equity (wc03501).

On the other hand, proportion of specific foreign director (FORS) was computed as total foreign directors from countries with strong corporate governance system⁶² divided by board of director size; Non-Executive Directors’ Remuneration (NREMU) was obtained from the sampled firms’ annual report in the corporate governance statement or notes of account for operating expenses sections; Proportion of family-member directors with Accounting & Finance background (NFACF) was calculated as total number of family-member directors with Accounting & Finance background divided by board sizeSize of board of directors (BDSZ) was calculated as

⁶² This category was developed in consideration of the corporate governance standard ranking of the respective countries, namely, European countries (i.e. UK, France, Germany, Denmark and Switzerland), US, Australia and Singapore as reported by Cornelius (2005) and FTSE (2005)

Table 6.43: Descriptive Statistics of Control Variables for Year 2002 and 2003 (before data transformation)

(Notes: 02= Year 2002; 03 = Year 2003; RM = Malaysian Ringgit; ASET =Total Assets; DEQ = Debt to equity Ratio; FORS= Proportion of Specific Foreign Directors; NREMU= Non-Executive Directors' Remuneration; FACF = Proportion of family-member directors with accounting and finance background; AUF5 = Firm's External Auditor is one of the Big 5 Audit Firms; INDPV = Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings; INSTL = Total Proportion of Government Agencies', Public Limited Companies'/Corporations' and/or Other Institutions' Substantial Equity Holdings; BDSZ= Size of Board of Directors)

Descrip. Stat.	ASET02 (RM'000)	DEQ02	FORS02	NREMU02 (RM'000)	FACF02	AUF502	INDPV02	INSTL02	BDSZ02
Mean	2889800.61	2.03	0.06	229.32	0.03	0.73	0.26	0.25	8.01
Std. Dev.	12297998.53	5.16	0.12	286.18	0.09	0.45	0.22	0.28	2.06
Skewness	8.96	6.36	2.36	4.08	3.78	-1.04	0.26	0.71	0.48
Kurtosis	96.36	54.56	5.11	23.16	17.80	-0.94	-1.06	-1.05	0.63
Min	4626.00	-4.87	0.00	0.00	0.00	0.00	0.00	0.00	4.00
Max	149663840.00	55.17	0.60	2433.00	0.67	1.00	0.81	0.83	16.00
Descrip. Stat.	ASET03 (RM'000)	DEQ03	FORS03	NREMU03 (RM'000)	FACF03	AUF503	INDPV03	INSTL03	BDSZ03
Mean	3041629.82	1.99	0.05	238.24	0.03	0.71	0.24	0.26	7.70
Std. Dev.	13040441.41	3.94	0.12	257.53	0.09	0.45	0.21	0.29	1.99
Skewness	9.08	3.59	2.77	3.06	4.10	-0.93	0.37	0.75	0.35
Kurtosis	98.97	14.87	8.55	13.74	21.11	-1.14	-0.94	-0.88	0.10
Min	4982.00	-5.45	0.00	0.00	0.00	0.00	0.00	0.00	3.00
Max	159844528.00	26.72	0.73	2022.00	0.67	1.00	0.89	1.00	14.00

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Table 6.44: Descriptive Statistics of Control Variables for Year 2002 and 2003 (After Normal Scores Transformation)

(Notes: 02= Year 2002; 03 = Year 2003; ASET =Total Assets; DEQ = Debt to equity Ratio; FORS= Proportion of Specific Foreign Directors; NREMU= Non-Executive Directors' Remuneration; FAF= Family-member Directors with Accounting & Finance Background; INDPV= Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings; INSTL = Total Proportion of Government Agencies', Public Limited Companies'/Corporations' and/or Other Institutions' Substantial Equity Holdings; BDSZ= Size of Board of Directors, A letter N was inserted at the front of each control variable's acronym to identify the variables that had been transformed to normal score using Van der Waerden approach)

Deserp. Stat.	NASET02	NDEQ02	NFORS02	NNREMU02	NFACF02	NINDPV02	NINSTL02	NBDSZ02
Mean	0.0000	0.0004	0.0745	0.0000	0.0719	0.0316	0.0438	0.0027
Std. Dev.	0.9813	0.9804	0.7104	0.9812	0.6631	0.9081	0.8766	0.9568
Skewness	0.0000	0.0053	1.6060	0.0002	1.9795	0.4029	0.5512	0.0486
Kurtosis	-0.2179	-0.2276	1.2643	-0.2181	2.5675	-0.6311	-0.6473	-0.2536
Min	-2.6117	-2.6117	-0.3038	-2.6117	-0.2278	-1.0619	-0.8644	-2.0482
Max	2.6117	2.7117	2.6117	2.6117	2.6117	2.6117	2.3652	2.6117
Deserp. Stat.	NASET03	NDEQ03	NFORS03	NNREMU03	NFACF03	NINDPV03	NINSTL03	NBDSZ03
Mean	0.0000	0.0004	0.0742	0.0000	0.0711	0.0334	0.0443	0.0019
Std. Dev.	0.9813	0.9804	0.6972	0.9812	0.6544	0.9043	0.8780	0.9573
Skewness	0.0000	0.0055	1.7074	0.0001	2.0515	0.4240	0.5620	0.0278
Kurtosis	-0.2179	-0.2285	1.5917	-0.2179	2.8533	-0.6313	-0.6025	-0.2170
Min	-2.6117	-2.6117	-0.2803	-2.6117	-0.2162	-1.0326	-0.8644	-2.6117
Max	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117	2.6117

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the total number of directors in the board of director; The name of the big 5 audit firms (i.e. PwC, KPMG, Ernst & Young, Arthur Andersen and Deloitte) [AUDF5] was obtained from the firm's annual report's section of corporate information.

On the other hand, substantial shareholders' equity holding in the company was obtained from the company's annual report's section of Analysis of Shareholdings, [i.e. INDPVC= Total proportion of Individuals' and/or Private Companies' substantial equity holdings; INSTL = Total proportion of Government Agencies', Public Limited Companies'/Corporations' and/or Other Institutions' substantial equity holdings]

Subsequently, the correlation analysis of the control variables is presented in Tables 6.45 and 6.46. The results indicated that the correlation amongst the control variables was less than 0.7.

With respect to board of directors' meeting frequency, the results in Table 6.47 indicated that more than 97% of the 221 firms conducted board meeting at least four times a year. These meetings may have coincided with the preparation of an interim report (i.e. every quarter of the year). In addition, some firms held 5 or more meetings in a year. The frequency of board meeting is one of the indicators of board commitment to perform their duties appropriately and in the best interests of shareholders (Lipton and Lorsch, 1992). On the other hand poor firm performance may have influenced the board to convene more meetings namely to plans for remedy of the situation (Vafeas, 1999). Moreover, particular event such as firm restructuring, merger and acquisition may also influence the number of board meetings (Johnson et al., 1993).

Table 6.45: Spearman Correlation Analysis of Control Variables for Year 2002 (2-tailed test)

[Notes: 02 Year 2002; ASET Total Assets; DEQ Debt to equity Ratio; FORS Proportion of Specific Foreign Directors; NREMU Non-Executive Directors' Remuneration; FACF Family-member Directors with Accounting & Finance Background; AUF5 Firm's External Auditor is one of the Big 5 Audit Firms; INDPV Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings; INSTL Total Proportion of Government Agencies', Public Limited Companies' Corporations' and/or Other Institutions' Substantial Equity Holdings; BDSZ Size of Board of Directors; MAINB Main Board firms; TRADG Trading and services industry; PLANT Plantation industry; FIN Finance; (FIN), CONSTR Construction industry; CONPRO Consumer products industry; PROP Property industry; MISCL Miscellaneous industries (i.e. which includes infrastructure project companies, the hotel industry, and mining A letter N was inserted at the front of each control variable's acronym to identify the variables that had been transformed to normal score using Van der Waerden approach; Figures in Italics represent the p-value of variables' correlation]

Variable	NASET02	NDEQ02	NFORS02	NNREMU02	NFACF02	AUF502	NINDPV02	NINSTL02	NBDSZ02	MAINB	TRADG	PROP	PLANT	CONSTR	CONPRO	FIN	MISCEL
NASET02	1.0000	0.1837	0.1038	0.5846	0.1154	0.2056	-0.3229	0.3430	0.3091	0.6483	0.1624	0.1548	0.0285	-0.0266	-0.1163	0.2963	0.1016
		0.0062	0.1239	0.0000	0.0869	0.0021	0.0000	0.0000	0.0000	0.0157	0.0213	0.6737	0.6939	0.0845	0.0000	0.1321	
NDEQ02	0.1837	1.0000	-0.1081	0.0558	0.0257	-0.0944	0.0670	-0.1297	-0.0186	-0.0785	0.1645	-0.0743	-0.3197	0.1966	0.0107	0.1487	0.0665
	0.0062		0.1092	0.4094	0.7037	0.1619	0.3217	0.0541	0.7833	0.2449	0.0144	0.2713	0.0000	0.0033	0.8745	0.0271	0.3250
NFORS02	0.1038	-0.1081	1.0000	0.0100	-0.0321	0.2465	-0.2755	0.3622	0.1057	0.1578	-0.0247	-0.0956	0.0734	-0.1157	0.1019	0.0106	-0.0089
	0.1239	0.1092		0.8824	0.6347	0.0002	0.0000	0.0000	0.1173	0.0189	0.7146	0.1567	0.2772	0.0861	0.1310	0.8750	0.8955
NNREMU02	0.5846	0.0558	0.0100	1.0000	0.0184	0.0369	-0.1675	0.2445	0.3667	0.4055	0.0673	0.0400	0.0800	-0.0310	-0.0577	0.2443	0.1056
	0.0000	0.4094	0.8824		0.7854	0.5851	0.0127	0.0002	0.0000	0.3191	0.5541	0.2363	0.6466	0.3929	0.0002	0.1175	
NFACF02	0.1154	0.0257	-0.0321	0.0184	1.0000	-0.0784	0.1189	-0.1707	-0.0122	-0.0030	-0.0386	-0.0136	-0.0402	-0.0571	-0.0224	0.2049	0.0234
	0.0869	0.7037	0.6347	0.7854		0.2457	0.0777	0.0110	0.8572	0.9652	0.5681	0.8408	0.5517	0.3982	0.7409	0.0022	0.7296
AUF502	0.2056	-0.0944	0.2465	0.0369	-0.0784	1.0000	-0.1573	0.2492	0.0725	0.1693	0.0034	-0.0485	0.0617	-0.0911	-0.1247	0.0057	0.0829
	0.0021	0.1619	0.0002	0.5851	0.2457		0.0193	0.0002	0.2830	0.0117	0.9595	0.4729	0.3615	0.1774	0.0643	0.2197	
NINDPV02	-0.3229	0.0670	-0.2755	-0.1675	0.1189	-0.1573	1.0000	-0.7157	-0.1195	-0.3425	-0.0349	-0.0106	-0.1628	0.1190	-0.0299	-0.0657	0.0528
	0.0000	0.3217	0.0000	0.0127	0.0777	0.0193		0.0000	0.0763	0.0000	0.6059	0.8754	0.0154	0.0774	0.6587	0.3312	0.4351
NINSTL02	0.3430	-0.1297	0.3622	0.2445	-0.1707	0.2492	-0.7157	1.0000	0.2018	0.3456	-0.0386	0.0432	0.1642	-0.1791	0.0379	0.0941	-0.0455
	0.0000	0.0541	0.0000	0.0002	0.0110	0.0002	0.0000		0.0026	0.0000	0.5680	0.5229	0.0145	0.0076	0.5754	0.1635	0.5012
NBDSZ02	0.3091	-0.0186	0.1057	0.3667	-0.0122	0.0725	-0.1195	0.2018	1.0000	0.1737	-0.0043	-0.0055	-0.0150	0.0322	0.0980	-0.0220	-0.0154
	0.0000	0.7833	0.1173	0.0000	0.8572	0.2830	0.0763	0.0026		0.0097	0.9488	0.9347	0.8249	0.6338	0.1465	0.7445	0.8204
MAINB	0.6483	-0.0785	0.1578	0.4055	-0.0030	0.1693	-0.3425	0.3456	0.1737	1.0000	0.0603	0.2155	0.1782	-0.1256	-0.0623	0.1894	0.0838
	0.0000	0.2449	0.0189	0.0000	0.9652	0.0117	0.0000	0.0000	0.0097		0.3721	0.0013	0.0079	0.0622	0.3563	0.0047	0.2145
TRADG	0.1624	0.1645	-0.0247	0.0673	-0.0386	0.0034	-0.0349	-0.0386	-0.0043	0.0603	1.0000	-0.1666	-0.1378	-0.1378	-0.1964	-0.1464	-0.0648
	0.0157	0.0144	0.7146	0.3191	0.5681	0.9595	0.6059	0.5680	0.9488	0.3721		0.0131	0.0407	0.0407	0.0034	0.0296	0.3376
PROP	0.1548	-0.0743	-0.0956	0.0400	-0.0136	-0.0485	-0.0106	0.0432	-0.0055	0.2155	-0.1666	1.0000	-0.1008	-0.1008	-0.1436	-0.1070	-0.0474
	0.0213	0.2713	0.1567	0.5541	0.8408	0.4729	0.8754	0.5229	0.9347	0.0013	0.0131		0.1354	0.1354	0.0328	0.1125	0.4834
PLANT	0.0285	-0.3197	0.0734	0.0800	-0.0402	0.0617	-0.1628	0.1642	-0.0150	0.1782	-0.1378	-0.1008	1.0000	-0.0833	-0.1188	-0.0885	-0.0392
	0.6737	0.0000	0.2772	0.2363	0.5517	0.3615	0.0154	0.0145	0.8249	0.0079	0.0407	0.1354		0.2172	0.0781	0.1898	0.5622
CONSTR	-0.0266	0.1966	-0.1157	-0.0310	-0.0571	-0.0911	0.1190	-0.1791	0.0322	-0.1256	-0.1378	-0.1008	-0.0833	1.0000	-0.1188	-0.0885	-0.0392
	0.6939	0.0033	0.0861	0.6466	0.3982	0.1774	0.0774	0.0076	0.6338	0.0622	0.0407	0.1354	0.2172		0.0781	0.1898	0.5622
CONPRO	-0.1163	0.0107	0.1019	-0.0577	-0.0224	-0.1247	-0.0299	0.0379	0.0980	-0.0623	-0.1964	-0.1436	-0.1188	-0.1188	1.0000	-0.1262	-0.0559
	0.0845	0.8745	0.1310	0.3929	0.7409	0.0643	0.6587	0.5754	0.1465	0.3563	0.0034	0.0328	0.0781	0.0781		0.0611	0.4086
FIN	0.2963	0.1487	0.0106	0.2443	0.2049	0.0057	-0.0657	0.0941	-0.0220	0.1894	-0.1464	-0.1070	-0.0885	-0.0885	-0.1262	1.0000	-0.0416
	0.0000	0.0271	0.8750	0.0002	0.0022	0.9323	0.3312	0.1635	0.7445	0.0047	0.0296	0.1125	0.1898	0.1898	0.0611		0.5380
MISCEL	0.1016	0.0665	-0.0089	0.1056	0.0234	0.0829	0.0528	-0.0455	-0.0154	0.0838	-0.0648	-0.0474	-0.0392	-0.0392	-0.0559	-0.0416	1.0000
	0.1321	0.3250	0.8955	0.1175	0.7296	0.2197	0.4351	0.5012	0.8204	0.2145	0.3376	0.4834	0.5622	0.5622	0.4086	0.5380	

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Table 6.46: Spearman Correlation Analysis of Control Variables for Year 2003 (2-tailed test)

[Notes: 03 Year 2003; ASET Total Assets; DEQ Debt to equity Ratio; FORS Proportion of Specific Foreign Directors; NNREMU Non-Executive Directors' Remuneration; NFACF Family-member Directors with Accounting & Finance Background; AUF5 Presence of Big 5 Audit Firm; NINDPV Total Proportion of Individuals' and or Private Companies' Substantial Equity Holdings; INSTL Total Proportion of Government Agencies', Public Limited Companies' Corporations' and or Other Institutions' Substantial Equity Holdings; BDSZ Size of Board of Directors; MAINB Main Board firms; TRADG Trading and services industry; PLANT Plantation industry; FIN Finance; (FIN), CONSTR Construction industry; CONPRO Consumer products industry; PROP Property industry; MISCL Miscellaneous industries (i.e. which includes infrastructure project companies, the hotel industry, and mining A letter N was inserted at the front of each control variable's acronym to identify the variables that had been transformed to normal score using Van der Waerden approach; Figures in *italics* represent the p-value of variables' correlation]

Variable	NASET03	NDEQ03	NFOR03	NNREMU03	NFACF03	AUF503	NINDPV03	NINSTL03	NBDSZ03	MAINB	TRADG	PROP	PLANT	CONSTR	CONPRO	FIN	MISCEL
NASET03	1.0000	0.1523	0.1762	0.5895	0.0645	0.2460	-0.3840	0.3908	0.3011	0.6558	0.1642	0.1580	0.0415	-0.0492	-0.1227	0.2943	0.1016
		<i>0.0236</i>	<i>0.0087</i>	<i>0.0000</i>	<i>0.3400</i>	<i>0.0002</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.0145</i>	<i>0.0188</i>	<i>0.5392</i>	<i>0.4664</i>	<i>0.0686</i>	<i>0.0000</i>	<i>0.1321</i>
NDEQ03	0.1523	1.0000	-0.0767	-0.0706	-0.0066	-0.0818	-0.0345	-0.1258	-0.0862	-0.0648	0.1529	-0.1109	-0.2609	0.2668	0.0232	0.1077	0.0662
			<i>0.2562</i>	<i>0.2962</i>	<i>0.9218</i>	<i>0.2259</i>	<i>0.6099</i>	<i>0.0620</i>	<i>0.2018</i>	<i>0.3375</i>	<i>0.0230</i>	<i>0.1001</i>	<i>0.0001</i>	<i>0.7318</i>	<i>0.1105</i>	<i>0.3270</i>	
NFOR03	0.1762	-0.0767	1.0000	0.0710	-0.0864	0.2207	-0.2679	0.3403	0.0757	0.2298	0.0011	-0.0508	0.0816	-0.1100	0.0578	-0.0191	-0.0033
				<i>0.2934</i>	<i>0.2006</i>	<i>0.0010</i>	<i>0.0001</i>	<i>0.0000</i>	<i>0.2627</i>	<i>0.0006</i>	<i>0.9867</i>	<i>0.4524</i>	<i>0.2267</i>	<i>0.1028</i>	<i>0.3924</i>	<i>0.7772</i>	<i>0.9612</i>
NNREMU03	0.5895	-0.0706	0.0710	1.0000	-0.0307	0.1284	-0.3140	0.3574	0.3992	0.4111	0.0661	0.0357	0.0893	-0.0439	-0.0478	0.2076	0.0708
					<i>0.2934</i>	<i>0.6503</i>	<i>0.0567</i>	<i>0.0000</i>	<i>0.0000</i>	<i>0.3284</i>	<i>0.5978</i>	<i>0.1859</i>	<i>0.5160</i>	<i>0.4799</i>	<i>0.0019</i>	<i>0.2950</i>	
NFACF03	0.0645	-0.0066	-0.0864	-0.0307	1.0000	-0.0184	0.1000	-0.1804	0.0706	-0.0307	-0.0311	0.0014	-0.1308	0.0302	-0.0250	0.1324	0.0283
						<i>0.7852</i>	<i>0.1386</i>	<i>0.0072</i>	<i>0.2960</i>	<i>0.6504</i>	<i>0.6458</i>	<i>0.9836</i>	<i>0.0522</i>	<i>0.6556</i>	<i>0.7118</i>	<i>0.0493</i>	<i>0.6754</i>
AUF503	0.2460	-0.0818	0.2207	0.1284	-0.0184	1.0000	-0.2390	0.2783	0.0920	0.1637	0.0224	-0.0337	0.0720	-0.1152	-0.1625	0.0179	0.0867
							<i>0.0002</i>	<i>0.2259</i>	<i>0.0010</i>	<i>0.0567</i>	<i>0.7852</i>	<i>0.0003</i>	<i>0.0000</i>	<i>0.1729</i>	<i>0.0148</i>	<i>0.7404</i>	<i>0.6187</i>
NINDPV03	-0.3840	-0.0345	-0.2679	-0.3140	0.1000	-0.2390	1.0000	-0.7196	-0.1101	-0.3520	-0.0390	0.0349	-0.1375	0.0699	-0.0309	-0.1022	0.0402
								<i>0.0000</i>	<i>0.1026</i>	<i>0.0000</i>	<i>0.5639</i>	<i>0.6059</i>	<i>0.0412</i>	<i>0.3010</i>	<i>0.6483</i>	<i>0.1298</i>	<i>0.5524</i>
NINSTL03	0.3908	-0.1258	0.3403	0.3574	-0.1804	0.2783	-0.7196	1.0000	0.2280	0.3746	-0.0552	0.0176	0.1608	-0.1172	0.0781	0.1268	-0.0490
									<i>0.0000</i>	<i>0.0006</i>	<i>0.0000</i>	<i>0.4138</i>	<i>0.7947</i>	<i>0.0168</i>	<i>0.0822</i>	<i>0.2473</i>	<i>0.0599</i>
NBDSZ03	0.3011	-0.0862	0.0757	0.3992	0.0706	0.0920	-0.1101	0.2280	1.0000	0.1578	-0.0353	0.0226	0.0125	0.0262	0.0826	0.0167	0.0119
										<i>0.0189</i>	<i>0.6015</i>	<i>0.7378</i>	<i>0.8529</i>	<i>0.6989</i>	<i>0.2211</i>	<i>0.8054</i>	<i>0.8608</i>
MAINB	0.6558	-0.0648	0.2298	0.4111	-0.0307	0.1637	-0.3520	0.3746	0.1578	1.0000	0.0603	0.2155	0.1782	-0.1256	-0.0623	0.1894	0.0838
											<i>0.3721</i>	<i>0.0013</i>	<i>0.0079</i>	<i>0.0622</i>	<i>0.3563</i>	<i>0.0047</i>	<i>0.2145</i>
TRADG	0.1642	0.1529	0.0011	0.0661	-0.0311	0.0224	-0.0390	-0.0552	-0.0353	0.0603	1.0000	-0.1666	-0.1378	-0.1378	-0.1964	-0.1464	-0.0648
												<i>0.0131</i>	<i>0.0407</i>	<i>0.0407</i>	<i>0.0034</i>	<i>0.0296</i>	<i>0.3376</i>
PROP	0.1580	-0.1109	-0.0508	0.0357	0.0014	-0.0337	0.0349	0.0176	0.0226	0.2155	-0.1666	1.0000	-0.1008	-0.1008	-0.1436	-0.1070	-0.0474
													<i>0.1354</i>	<i>0.1354</i>	<i>0.0328</i>	<i>0.1125</i>	<i>0.4834</i>
PLANT	0.0415	-0.2609	0.0816	0.0893	-0.1308	0.0720	-0.1375	0.1608	0.0125	0.1782	-0.1378	-0.1008	1.0000	-0.0833	-0.1188	-0.0885	-0.0392
														<i>0.1354</i>	<i>0.0781</i>	<i>0.1898</i>	<i>0.5622</i>
CONSTR	-0.0492	0.2668	-0.1100	-0.0439	0.0302	-0.1152	0.0699	-0.1172	0.0262	-0.1256	-0.1378	-0.1008	-0.0833	1.0000	-0.1188	-0.0885	-0.0392
															<i>0.0781</i>	<i>0.1898</i>	<i>0.5622</i>
CONPRO	-0.1227	0.0232	0.0578	-0.0478	-0.0250	-0.1625	-0.0309	0.0781	0.0826	-0.0623	-0.1964	-0.1436	-0.1188	-0.1188	1.0000	-0.1262	-0.0559
																<i>0.0611</i>	<i>0.4086</i>
FIN	0.2943	0.1077	-0.0191	0.2076	0.1324	0.0179	-0.1022	0.1268	0.0167	0.1894	-0.1464	-0.1070	-0.0885	-0.0885	-0.1262	1.0000	-0.0416
																	<i>0.5380</i>
MISCEL	0.1016	0.0662	-0.0033	0.0708	0.0283	0.0867	0.0402	-0.0490	0.0119	0.0838	-0.0648	-0.0474	-0.0392	-0.0392	-0.0559	-0.0416	1.0000

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Table 6.47: Board of Director Attendance and Frequency of Meetings in Year 2002 and 2003

(Note: BATEND = Average Rate of Board of Director's Attendance in Board's Meeting; NBATEND = Normal Scores of Average Rate of Board of Director's Attendance in Board's Meeting; BDMT4 = Frequency of Board Meeting of 4 or more, BDMTG4 = Frequency of Board Meeting of 5 or more)

Board of Directors Attendance in Board Meetings								
Descriptive Statistics		Max	Min	Mean	Std Dev	Skewness	Kurtosis	Sum
BATEND	Yr 2002	1	0.73	0.9153	0.0585	-0.5866	0.0873	NAPP
	Yr 2003	1	0.75	0.9254	0.0565	-0.7515	0.2499	NAPP
NBATEND	Yr 2002	1.5116	-2.6117	-0.0118	0.9504	-0.1727	-0.5054	NAPP
	Yr 2003	1.4285	-2.4699	-0.0142	0.9433	-0.1989	0.5556	NAPP
Frequency of Board of Director Meetings								
Descriptive Statistics		Max	Min	Mean	Std Dev	Skewness	Kurtosis	Sum
Yr 2002	BDMT4	1	0	0.9729	0.1629	-5.859	32.622	215
	BDMTG4	1	0	0.6833	0.4663	-0.793	-1.383	151
Yr 2003	BDMT4	1	0	0.9729	0.1629	-5.859	32.622	215
	BDMTG4	1	0	0.6552	0.4730	-0.705	-1.517	147

N = 221 firms

Nevertheless board members attendance at meetings had been encouraging with a mean of 0.90 in 2002 and 2003.

Table 6.48: Audit Committee Attendance and Frequency of Meetings in Year 2002 and 2003

(Note: ATEND = Average Rate of Audit Committee Member's Attendance in Audit Committee Meetings, NATEND = Normal Scores of Average Rate of Audit Committee Member's Attendance in Audit Committee Meetings, ACMET4 = Frequency of Audit Committee Meeting of 4 or more, AMETG4 = Frequency of Audit Committee Meeting of 5 or more)

Audit Committee Members Attendance in Audit Committee Meetings								
Descriptive Statistics		Max	Min	Mean	Std Dev	Skewness	Kurtosis	Sum
ATEND	Yr 2002	1	0.67	0.9433	0.0682	-1.2697	1.479	NAPP
	Yr 2003	1	0.7	0.97	0.0639	-1.4810	2.0219	NAPP
NATEND	Yr 2002	-2.6117	0.725	-0.0536	0.8495	-0.7056	-0.5165	NAPP
	Yr 2003	-2.6117	0.6745	-0.0573	0.8384	0.7695	-0.4593	NAPP
Frequency of Audit Committee Meetings								
Descriptive Statistics		Max	Min	Mean	Std Dev	Skewness	Kurtosis	Sum
Yr 2002	ACMET4	1	0	0.9819	0.1336	-7.279	51.452	217
	AMETG4	1	0	0.5928	0.4924	-0.38	-1.872	131
Yr 2003	ACMET4	1	0	0.982	0.1333	-7.296	51.702	218
	AMETG4	1	0	0.6199	0.4861	-0.497	-1.769	137

N = 221 firms

In reference to Table 6.48, the result indicated a percentage of more than 98% of the 221 firms convening audit committee meeting at least 4 times a year. Again this may coincide with interim report preparation (as stated in most of the companies audit committee report). Also there has

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been an increased in the number of audit committee conducting more than quarterly meeting. According to Scarbrough et al., (1998) the frequency of audit committee may relate to the performance of task such as the evaluation of firm's internal audit program and process. Furthermore, the commitment of audit committee in performing oversight duties has a potential linked with the number of meetings it held with the internal auditor, external auditor and counsel (Menon and William, 1994). Audit committee members commitment in fulfilling their oversight duties further indicated by their attendance at meeting (PwC, 2003). Results in Table 6.48 present, on average the attendance rate of audit committee member at meeting in 2002 and 2003 had been high with less than 10% members' absenteeism.

6.6 Preliminary Regression Analysis

The ordinary least square models in Chapter 5 were analysed using multiple regression analysis. There were several assumptions that needed to be taken into account before proceeding with the analysis. Pallant (2005: 142-143) identified seven assumptions of regression analysis. The first is the size of the sample. Tabachnick and Fidell (2001:117) suggest a formula of $50 + 8m$ to determine the appropriate size of the sample (where m is the number of independent variables to be used in the regression models). In the case of the current research the highest number of independent variables examined was 21 (i.e. see Chapter 5, regression model OLS 1). This gives an estimated sample size of 114. Based on this guideline the research sample, which was 221 satisfied the generalisability issue of the output that would be produced from the regression analysis.

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The second assumption requires the evaluation of multicollinearity problems amongst independent variables. In particular, Field (2005) identifies a case of multicollinearity when the correlation between the independent variables is high (i.e. $r = 0.7$ or above). To further assess the multicollinearity condition amongst independent variables, Hair et al., (1998:221) contend that independent variables that produced a variance-inflation factor (i.e. VIF) level below 10, condition index less than 15, and a regression coefficient variance-decomposition matrix below 0.9 indicate no multicollinearity problem amongst the variables. These analyses were performed on the independent variables and the results indicate no multicollinearity. Hence, the independent variables of the OLS models were free from multicollinearity.

On the other hand, the predictive value of the regression model could also be affected by the present of outliers or extreme value in the data sets. In particular, when there are distinctive characteristics amongst the variables in a data set, the inclusion of these variables in the analysis may affect the predictive value of the model (Hair et al., 1998). To overcome this problem, the data set can either be transformed to reduce the large differences amongst its values or the extreme values cases can be deleted from the observation.

For the current research, a normal scores data transformation technique using the Van der Waerden approach⁶³ was employed. This approach was undertaken in consideration of Cooke's (1998) support of the ability of this technique to avoid data deletion due to negative value and/or

⁶³ Van der Waerden approach is one of the methods of rank transformation. Rank transformation using the Van der Waerden approach transforms the data by dividing the rank of each data (r_i) with the total of size of sample (i.e. n) plus 1 [i.e. $(\frac{r_i}{n+1})$].

On the other hand, Van der Waerden scores corresponding to the observation with rank $r(i)$ is measured as $\Phi^{-1}(\frac{r_i}{n+1})$ where Φ is the normal cumulative distribution function.

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extreme value problems. In particular the normal scores were calculated using SPSS 12 rank cases function, with further adoption of Van der Waerden normal scores estimation. According to Tabachnick and Fidell (2001), it is preferable to choose a method of data improvement which avoids further deletion on the research data that has been collected. They argue that given the time consumption of some data collection process, the data collected should be retained whenever possible. Furthermore, Hair et al., (1998) indicated that as long as the extreme values in the sample data are not due to unexplained or extraordinary events, the data should not be excluded from the sample as they still represent most of the characteristics of the data group. In addition, a studentized residuals test⁶⁴, Mahalanobis distance and Cook distance methods can also be used to identify outliers in the sample data. However, following Cooke's (1998) suggestion, normal scores were calculated for all continuous and interval data of the dependent and independent variables. He emphasises this procedure is important to ensure consistency in the interpretation of the results.

Also, multiple regression analysis is based on the assumptions that the variables tested are normally distributed. In particular, the analysis assumes that the residuals⁶⁵ should be normally distributed about the predicted dependent variables' value (Tabachnick and Fidell, 2001:119). This also implies that a linear relationship should exist between the explanatory variables and the predicted dependent variables' value (Hair et al., 1998). This relationship can be observed from the analysis of the normal probability plot (i.e. Normal Q-Q) of the regression standardised residuals. When the points lie along the straight line in the plot, this suggests a normal distribution. In addition, a special case of White Test for heteroskedasticity (see Wooldridge,

⁶⁴ For instance, this method excludes data which gives a residual value of higher than +/- 1.96 (See Hair et al., 1998:223)

⁶⁵ This value represents the difference between the obtained and predicted dependent variable scores (see Pallant, 2005:143)

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2000:259-260) can be carried out by regressing the squared of the regression standardised residuals (\hat{u}^2) against the regression standardised predicted value (\hat{y}) and squared of regression standardised predicted value (\hat{y}^2) [i.e. $\hat{u}^2 = \delta_0 + \delta_1 \hat{y}_1 + \delta_2 \hat{y}_2^2 + error$]. The p-value of F^{66} or Lagrange Multiplier (LM) statistics⁶⁷ from this regression will provide evidence of whether the regression results of the research models violated the OLS homoscedasticity assumption [i.e. the variance of the error terms (i.e. residual) should remain constant over the range of independent variables (Hair et al., 1998: 144)]

In further evaluating that the errors of prediction are independent of one another, the Durbin Watson statistic can be used to identify the autocorrelation amongst the errors. A Durbin-Watson statistic (d) value of less than the Durbin-Watson derived lower limit (d_L) implies that the null hypothesis of no autocorrelation should be rejected (Maddala, 2005:229), whilst a Durbin Watson statistic of greater than the Durbin-Watson derived upper limit (d_U) implies that, the null hypothesis of no autocorrelation should not be rejected (Maddala, 2005:229).

For the current research hypotheses testing using multiple regression analysis, the characteristics of the dependent, explanatory and control variables fulfilled the analysis's assumptions. In particular the transformation of the research variables to normal scores have improved their normality, skewness and kurtosis level (see sections 6.5.1, 6.5.2 and 6.5.3).

⁶⁶ The p-value of F distribution is computed using $F_{2,n-3}$ distribution (see Wooldridge, 2001:260)

⁶⁷ Lagrange Multiplier (LM) value is calculated by multiplying the R-squared of the residuals regression with sample size. N and its p-value is computed using χ^2 distribution (see Wooldridge, 2001:260).

6.7 Further Specification on Research Models Observations

According to Bhagat and Black (2002), it is difficult to assess board members' contribution when they are likely to be replaced in a short time period. They further argue that to assess board of directors' performance in the year they were appointed may not fully capture their potential and contribution to the firm's value. In consideration of this argument, the current research models observed the impact of board of directors' and board subcommittees attributes' in 2002 with firm performance in 2002 and 2003 and, correspondingly corporate governance practice in 2003 with firm performance 2003 and 2004. Importantly, Jaggi and Leung (2007:47) noted the potential of heterocedasticity problems and contemporaneous correlations of residuals when two years data were pooled. Their research had used two years corporate governance data due to the availability of such information only in Hong Kong listed companies' annual reports. Accordingly, this argument further justified the current study's approach to examine the impact of firm corporate governance practice on firm performance based on individual year observation.

6.8 Conclusion

This chapter began with the discussion of the rationales for undertaking cross-sectional research. Later it elaborated the sampling procedures performed for identifying the suitable number of firms to be researched. Then it progressed with discussion of the sources of the data used in gathering the required information for examining the research hypotheses and developing the described in Chapter 5. Subsequently, the chapter described the parameters of the dependent, explanatory and control variables of the research models in Chapter 5. Further, the chapter discussed the multiple regression analysis assumptions and implementation for the testing of the

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research hypothesis. The next chapter 7 will analyse and discuss the multiple regression results of board of directors' attributes models (see Chapter 5 for OLS 1, 2 and 3 research models).

Chapter 7

~Analyses of Results and Discussion I~

The Impact of Board of Directors' Attributes on Firm Performance

7.0 Introduction

This chapter presents the results of the multiple regression analysis of the board of directors research models identified earlier in Section 5.1. The results are evaluated by linking the findings with the research hypotheses presented in Section 5.1. Subsequently, the results derived from the testing of hypotheses and data derived from the OLS 1 research model (i.e. the impact of board of directors' independence on firm performance), OLS 2 research model (i.e. the impact of board of directors' leadership on firm performance) and OLS 3 research model (i.e. the impact of board of directors' competency on firm performance) are respectively analysed and discussed.

7.1 Regression Models and Empirical Results

The empirical results derived from the multiple regression models are discussed in relation to board of directors' attributes, namely, independence, leadership and competency, and firm performance. Since the research is designed to evaluate the impact of firm corporate governance practice on firm performance in the years 2002, 2003 and 2004, the notation (a) and (b) represent the observation of independent variables in the years 2002 and 2003 respectively.

7.2 Board of Directors' Attributes and Firm Performance

This section examines the influence of board of directors' independence, leadership and competency on firm performance.

7.2.1 *Board of Directors' Independence and Firm Performance – OLS 1*

The impact of board of directors' independence on firm performance was examined by research models OLS 1(i), OLS 1(ii) and OLS 1(iii) [See Chapter 5, sub-section 5.1.1]. Specifically, each model respectively examined the impact of certain compositions of independent directors on the board, namely, the proportion of independent directors (NINED), domination of the board by independent directors (DOINED), and domination of the board by independent and non-executive directors (DONEDI), on firm performance. Such investigations was undertaken by evaluating together in each model other factors that may have influenced independent directors' effectiveness, namely, their financial knowledge (INACF), the presence of a senior independent director on the firm's board (SRI), the exclusion of the CEO from board membership (EXCEO), the appointment of an independent board chairman (CHINED), the presence of a founder on the firm's board (FOUD), the proportion of family-member directors on the board (NFAMDI), and the proportion of independent directors' share ownership in the firm (NINSDG). The following subsections will discuss the three OLS 1 model in turn.

I) Proportion of Independent Directors and Firm Performance (NINED) – OLS 1 (i)

Table 7.1 and 7.2 respectively present the regression results derived from the OLS 1(i)(a) research model [i.e. regression of NINED and specified board independence variables in 2002 with respective firm performance 2002 and 2003] and from the OLS 1(i)(b) research model [i.e. regression of NINED and specified board independence variables in 2003 with respective firm performance 2003 and 2004].

Table 7. 1: Board Independence and Firm Performance -- OLS 1(i)(a)
The Examination of Proportion of Independent Directors on the Board (NINED) in 2002 with Respective Firm Performance 2002 and 2003
(The Testing of HBIND1 with HBIND 4, 5, 6,7, 8, 9 and 10)

BOD = Board of Directors, NROE = Return on Equity, NINED = Proportion of Independent Directors, NINACF = Proportion of INEDs with accounting and finance background, SRI = Senior Independent Director appointment on BOD, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, CHIN = Board's Chairman INED, FOUN = Founder presence on BOD, NFAMDI = Proportion of family-member directors, NINSDG = Equity holdings of INED, NASET = Total Assets, NDEQ = Debt to equity ratio, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR = Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05(**), 0.01(***); All t-statistical values were significant at 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2192		0.1448		0.2076		0.1510	
R ²	0.2937		0.2265		0.2833		0.2320	
F	3.9413		2.7742		3.7451		2.8630	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0060	-0.0322	-0.1649	-0.8472	-0.1422	-0.7594	-0.1580	-0.8150
<i>Explanatory Variables (β)</i>								
NINED02	0.0025	0.0389	-0.0823	-1.2184	0.0216	0.3321	-0.1132	-1.6808*
NINACF02	-0.0230	-0.3303	0.0755	1.0347	-0.0299	-0.4254	0.0148	0.2040
SRI02	-0.1834	-1.4311	0.1879	1.4009	-0.1054	-0.8161	0.3061	2.2898**
EXCEO02	0.1366	0.8677	0.2093	1.2704	0.1366	0.8614	0.1666	1.0153
CHIN02	-0.0514	-0.3235	0.0697	0.4188	-0.1014	-0.6330	-0.0760	-0.4585
FOUD02	0.1665	1.0263	0.0952	0.5603	0.1581	0.9672	0.0181	0.1067
NFAMDI02	-0.1846	-1.9698*	0.0173	0.1759	-0.0915	-0.9698	0.0081	0.0832
NINSDG02	-0.0444	-0.6181	-0.0457	-0.6085	-0.0438	-0.6059	0.1241	1.6577*
<i>Control Variables</i>								
NASET02	-0.2536	-2.5923**	0.4112	4.0169***	-0.2531	-2.5683**	0.3050	2.9896***
NDEQ02	0.1573	2.1844**			0.3081	4.2464***	0.1293	1.7219*
NINSTL02					0.2099	2.0867**		
<i>Industry Dummy</i>								
PROP	-0.9347	-4.1736***			-0.8150	-3.6122***		
CONSTR	0.4292	1.7007*			0.5019	1.9745**		
FIN					-0.6185	-2.3655**		

Table 7. 2: Board Independence and Firm Performance -- OLS 1(i)(b)

**The Examination of Proportion of Independent Directors on the Board (NINED) in 2003 with Respective Firm Performance 2003 and 2004
(The Testing of HBIND 1 with HBIND 4, 5, 6, 7, 8, 9 and 10)**

BOD = Board of Directors, NROE = Return on Equity, NINED = Proportion of Independent Directors, NINACF = Proportion of INEDs with accounting and finance background, SRI = Senior Independent Director appointment on BOD, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, CHIN = Board's Chairman INED, FOUN = Founder presence on BOD, NFAMDI = Proportion of family-member directors, NINSDG = Equity holdings of INED, NASET = Total Assets, NDEQ = Debt to equity ratio, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, FIN = Finance industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

/ Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_U); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All t statistical values were significant at 0.05 level

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
<i>Adj R²</i>	0.2466		0.2081		0.0694		0.1182	
<i>R²</i>	0.3185		0.2837		0.1603		0.2043	
<i>F</i>	4.4288		3.7527		1.7640		2.3723	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1650	-0.8544	-0.0550	-0.2777	-0.0410	-0.1890	-0.1928	-0.9130
<i>Explanatory Variables (β)</i>								
NINED03	0.1051	1.5539	-0.1986	-2.8645***	0.1010	1.3285	-0.0800	-1.0826
NINACF03	0.0552	0.7877	0.0674	0.9376	0.0115	0.1463	0.0809	1.0564
SRI03	-0.0887	-0.7373	0.3152	2.5548**	0.0513	0.3795	0.0266	0.2025
EXCEO03	0.1222	0.8815	0.2562	1.8020*	0.0474	0.3041	0.2006	1.3232
CHIN03	0.0992	0.6373	-0.1790	-1.1217	0.0421	0.2406	0.3204	1.8825*
FOUD03	0.1833	1.0762	-0.1261	-0.7222	0.2222	1.1608	0.0520	0.2795
NFAMDI03	-0.0268	-0.2920	-0.0396	-0.4208	-0.0593	-0.5753	0.0022	0.0215
NINSDG03	-0.0700	-0.9781	0.0400	0.5449	-0.1465	-1.8227*	0.0511	0.6531
<i>Control Variables</i>								
NASET03	-0.3391	-3.3756***	0.4571	4.4375***	-0.2319	-2.0539**	0.2544	2.3168**
NDEQ03	0.3283	4.6740***					0.1570	2.0440**
NINSTL03	0.3067	3.0737***					0.2359	2.1626**
<i>Industry Dummy</i>								
PROP	-0.7219	-3.2637***	-0.4032	-1.7780*	-0.5220	-2.0998**		
FIN	-0.4867	-1.8955*	-0.4885	-1.8558*	-0.5159	-1.7877*		

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Specifically OLS 1(i) investigated the impact of the proportion of independent directors (NINED: HBIND 1), the proportion of independent directors with accounting and finance knowledge and skills (NINACF: HBIND 4), the presence of a senior independent outside director (SRI: HBIND 5), the exclusion of the Chief Executive Officer, Chief Financial Officer or Managing Director from membership of board of directors (ECXEO: HBIND 6), the appointment of an independent director as board of director's chairman (CHINED: HBIND 7), the presence of a founder on the firm's board (FOUD: HBIND 8), the proportion of family directors on the board (NFAMDI: HBIND 9) and the proportion of independent directors' shares ownership (NINDSG: HBIND 10), on firm performance.

Chapter 5 section 5.1.1 hypothesised that the proportion of independent directors (NINED) has a positive impact on firm performance (i.e. HBIND 1). OLS 1(i)(a) and OLS 1(i)(b) model results pointed to the contrary (see Tables 7.1 and 7.2). In most of the cases observed, the results indicated that the relationship between NINED in 2002 and firm performance in 2002 and 2003, and between NINED in 2003 and firm performance in 2003 and 2004 was not statistically significant, both in terms of the market value measure (NTobin's Q) and the accounting-based measure (NROE) of firm performance. Notably, the hypothesised positive relationship between NINED and firm performance was statistically rejected by two of the cases observed, indicated by a significant negative relationship between NINED in 2002 and NROE in 2003 ($\beta = -0.11$; $p = 0.1$) [see Table 7.1], and between NINED in 2003 and NROE in 2003 ($\beta = -0.20$; $p = 0.01$) [See Table 7.2].

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With respect to HBIND 5 testing, the results in Tables 7.1 and 7.2 indicated that given the proportion of independent directors on the firm's board (NINED), the relationship between the presence of a senior independent director (SRI) and firm performance was not statistically significant in most of the cases observed. Only in two of the cases observed was the hypothesised positive relationship between SRI and firm performance statistically supported. Specifically, there existed a significant positive relationship between SRI in 2002 and subsequent year firm performance, namely, NROE in 2003 ($\beta = 0.31$; $p = 0.05$) [see Table 7.1], and between SRI in 2003 and current year firm performance, namely, NROE in 2003 ($\beta = 0.32$; $p = 0.05$) [See Table 7.2].

In addition, HBIND 6 testing results (see Tables 7.1 and 7.2) indicated that, given the proportion of independent directors on the firm's board (NINED), the relationship between the non-presence of Chief Executive Officer, Chief Financial Officer or Managing Director on the firm's board (EXCEO) and firm performance was not statistically significant in most of the cases observed. Only in one case was HBIND 6 statistically supported, where there existed a significant positive relationship between EXCEO in 2003 with NROE in 2003 ($\beta = 0.26$; $p = 0.1$).

As regards to the results derived from testing HBIND 7 (see Tables 7.1 and 7.2), given the proportion of independent directors on the firm's board (NINED), most of the cases observed revealed that the relationship between the presence of an independent board chairman (CHINED) and firm performance was not statistically significant. However, there existed a

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significant positive relationship between CHINED in 2003 with subsequent year firm performance, namely, NROE in 2004 ($\beta = 0.32$; $p = 0.1$).

On the other hand, HBIND 9 testing results (see Tables 7.1 and 7.2) revealed that, given the proportion of independent directors on the firm's board (NINED), there existed significant negative relationship between the proportion of family-member directors on the board (NFAMDI) in 2002 and firm performance in terms of market value measure (NTobin's Q) in 2002 ($\beta = -0.18$; $p = 0.1$).

Furthermore, the results of HBIND 10 testing (see Tables 7.1 and 7.2) indicated that, given the proportion of independent directors on the firm's board (NINED), the relationship between the proportion of independent directors shareholdings in the firm (NINSDG) and firm performance was not statistically significant in most of the cases observed. In particular, the two cases which showed significant results revealed inconsistent relationship between NINSDG and firm performance. Notably there existed significant positive relationship between NINSDG in 2002 and NROE in 2003 ($\beta = 0.12$; $p = 0.1$) [see Table 7.1], whilst the relationship between NINSDG in 2003 and NTobin's Q in 2004 was significantly negative ($\beta = -0.15$; $p = 0.1$) [See Table 7.2].

For the testing of HBIND 4 and 8, OLS 1(i)(a) and OLS 1(i)(b) model results indicated that the respective hypothesised relationships were not statistically significant.

II) Domination of Independent Directors and Firm Performance (DOINED) - OLS 1(ii)

Tables 7.3 and 7.4 respectively present the regression results of the research model OLS 1(ii)(a) [i.e. regression of DOINED and specified board independence variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 1(ii)(b) [i.e. regression of DOINED and specified board independence variables in 2003 with respective firm performance 2003 and 2004].

In Chapter 5, section 5.1.1, HBIND 2 predicted that the domination of board of director composition by independent directors (DOINED) would have a positive impact on firm performance. OLS 1(ii)(a) and OLS 1(ii)(b) model results pointed to the contrary (see Tables 7.3 and 7.4). The relationship between DOINED in 2002 and firm performance in 2002 and 2003, and between DOINED in 2003 and firm performance in 2003 and 2004 was not statistically significant in most of the cases observed. Specifically, the hypothesised positive relationship between DOINED and firm performance was statistically rejected by one of the cases observed, indicated by a significant negative relationship between DOINED in 2003 and NROE in 2003 ($\beta = -0.42$; $p = 0.05$) [See Table 7.4].

With respect to HBIND 5 testing, the results in Tables 7.3 and 7.4 indicated that, when the board of director composition was dominated by independent directors (DOINED), the relationship between the presence of a senior independent director (SRI) and firm performance was not statistically significant in most of the cases observed. However, HBIND 5 was supported in two of the cases observed where there existed significant positive relationship between SRI in 2002

Table 7. 3: Board Independence and Firm Performance -- OLS 1(ii)(a)

The Examination of Domination of Independent Directors on the Board (DOINED) in 2002 with Respective Firm Performance 2002 and 2003

(The Testing of HBIND 2 with HBIND 4, 5, 6, 7, 8, 9 and 10)

BOD - Board of Directors, NROE - Return on Equity, DOINED - Domination of Independent Directors, NINACE - Proportion of INEDs with accounting and finance background, SRI - Senior Independent Director appointment on BOD, EXCEO - Exclusion of CEO, CFO, COO and Managing Director, CHIN - Board's Chairman, INED, FOUN - Founder presence on BOD, NFAMDI - Proportion of family-member directors, NINSDG - Equity holdings of INED, NASET - Total Assets, NDEQ - Debt to equity ratio, NINSTL - Total proportion of Government Agencies', Public Listed Companies', Corporations' and Other Institutions' substantial equity holdings, PROP - Property industry, CONSTR - Construction industry, FIN - Finance industry, 02 - Year 2002, 03 - Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All t-statistical values were significant at 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2200		0.1473		0.2077		0.1455	
R ²	0.2945		0.2287		0.2833		0.2271	
F	3.9550		2.8097		3.7460		2.7838	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.0032	0.0173	-0.1286	0.6578	-0.1363	-0.7233	-0.1241	-0.6342
<i>Explanatory Variables (β)</i>								
DOINED02	0.0692	0.4524	0.2299	-1.4372	-0.0541	0.3508	-0.1980	-1.2368
NINACF02	-0.0202	0.2942	0.0674	0.9370	-0.0239	-0.3451	-0.0003	-0.0040
SRI02	-0.1797	-1.3993	0.2001	1.4906	0.1023	-0.7909	0.3164	2.3541**
EXCEO02	0.1440	0.9137	0.2179	1.3221	0.1459	0.9183	0.1666	1.0095
CHIN02	0.0441	-0.2779	0.0680	0.4101	-0.0899	-0.5630	-0.0898	-0.5410
FOUD02	0.1692	1.0432	0.0965	0.5688	0.1618	0.9899	0.0157	0.0922
NFAMDI02	0.1895	2.0264**	0.0166	0.1694	-0.0988	-1.0481	0.0148	0.1516
NINSDG02	0.0445	-0.6208	-0.0498	-0.6647	-0.0431	-0.5969	0.1189	1.5836
<i>Control Variables</i>								
NASET02	-0.2549	-2.6058***	0.4062	3.9720***	-0.2540	-2.5761**	0.3003	2.9334***
NDEQ02	0.1629	2.2415**			0.3144	4.2910***	0.1338	1.7581*
NINSTL02					0.2058	2.0588**		
<i>Industry Dummy</i>								
PROP	-0.9330	-4.1678***			-0.8146	-3.6107***		
CONSTR	0.4276	1.6965*			0.4978	1.9596*		
FIN					-0.6212	-2.3765**		

Table 7. 4: Board Independence and Firm Performance -- OLS 1(ii)(b)
The Examination of Domination of Independent Directors on the Board (DOINED) in 2003 with Respective Firm Performance 2003 and 2004
(The Testing of HBIND 2 with HBIND 4, 5, 6, 7, 8, 9 and 10)

BOD - Board of Directors, NROE - Return on Equity, DOINED - Domination of Independent Directors, NINACE - Proportion of INEDs with accounting and finance background, SRI - Senior Independent Director appointment on BOD, EXCEO - Exclusion of CEO, CFO, COO and Managing Director, CHIN - Board's Chairman INED, FOUN - Founder presence on BOD, NFAMDI - Proportion of family member directors, NINSDG - Equity holdings of INED, NASET - Total Assets, NDEQ - Debt to equity ratio, NNREMU - Non-Executive Directors' Remuneration, NINDPV - Total proportion of Individuals' and/or Private Companies' substantial equity holdings, NINSTL - Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP - Property industry, FIN - Finance industry, 03 - Year 2003, 04 - Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for Durbin Watson statistic, (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***)]. All F-statistical values were significant at 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
<i>Adj R²</i>	0.2374		0.1936		0.0702		0.1232	
<i>R²</i>	0.3102		0.2705		0.1610		0.2089	
<i>F</i>	4.2621		3.5145		1.7729		2.4388	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.1993	1.0321	0.0124	0.0624	-0.0758	-0.3517	-0.1647	-0.7874
<i>Explanatory Variables (β)</i>								
DOINED03	-0.0050	-0.0259	-0.4209	-2.1153**	0.2996	1.3868	-0.3173	-1.5135
NINACF03	0.0809	1.1791	0.0261	0.3703	0.0310	0.4050	0.0668	0.8989
SRI03	-0.0817	-0.6696	0.3357	2.6767***	0.0342	0.2511	0.0465	0.3519
EXCEO03	0.1409	1.0042	0.2637	1.8273*	0.0350	0.2236	0.2183	1.4358
CHIN03	0.1436	0.9303	-0.2408	-1.5176	0.0691	0.4012	0.3030	1.8123*
FOUD03	0.1748	1.0131	-0.1554	-0.8759	0.2461	1.2778	0.0247	0.1319
NFAMDI03	-0.0385	-0.4151	0.0098	0.1022	-0.0898	-0.8669	0.0314	0.3120
NINSDG03	-0.0635	-0.8827	0.0188	0.2536	-0.1339	-1.6673*	0.0394	0.5059
<i>Control Variables</i>								
NASET03	-0.3373	-3.3316***	0.4399	4.2248***	-0.2204	-1.9498*	0.2428	2.2133**
NDEQ03	0.3359	4.7634***					0.1541	2.0165**
NNREMU03					0.1551	1.7390*		
NINDPV03							0.1666	1.6627*
NINSTL03	0.2974	2.9283***					0.2706	2.4593**
<i>Industry Dummy</i>								
PROP	-0.7126	3.2013***	-0.4385	-1.9156*	0.1551	1.7390**		
FIN	-0.4775	-1.8461*	-0.4747	-1.7846*	-0.5291	-1.8321*		

and NROE in 2003 ($\beta = 0.32$; $p = 0.05$) and between SRI in 2003 and NROE in 2003 ($\beta = 0.34$; $p = 0.01$). These results were consistent with the respective findings of OLS 1.

HBIND 6 testing results (see Tables 7.3 and 7.4) also showed that, when the board of director composition was dominated by independent directors (DOINED), there were two cases where the hypothesised positive relationship between the non-presence of Chief Executive Officer, Chief Financial Officer or Managing Director on the firm's board (EXCEO) and firm performance was supported. In particular, there existed a significant positive relationship between EXCEO in 2003 and NROE in 2003 ($\beta = 0.26$; $p = 0.1$). This result was consistent with OLS 1(i)(b) finding on the relationship between EXCEO and firm performance.

For HBIND 7 testing, when the board of director composition was dominated by independent directors (DOINED), there existed a significant positive relationship between the presence of an independent board's chairman (CHINED) in 2003 and NROE in 2004 ($\beta = 0.30$; $p = 0.1$). This result supported the respective finding of OLS (i)(b).

HBIND 9 results indicated that when the board of director composition was dominated by independent director (DOINED) [see Table 7.3] there existed a significant negative relationship between NFAMDI in 2002 with NTobin's Q in 2002 ($\beta = -0.20$; $p = 0.05$). This result was consistent with the previous OLS 1(i)(a) finding, where a significant negative relationship was found between NFAMDI and firm performance.

In accordance with OLS 1(i)(b) significant finding on the relationship between NINSDG and firm performance, the results of OLS 1(ii)(b) on HBIND 10 testing also showed that, when the board of director composition was dominated by independent director (DOINED), there existed a significant negative relationship between NINSDG in 2003 and NTobin's Q in 2004 ($\beta = -0.13$; $p = 0.1$).

Similar to results derived from previous OLS 1(i)(a) and (b) results, OLS 1(ii)(a) and OLS 1(ii)(b) model testing of HBIND 4 and 8 indicated that, in all the cases observed the respective hypothesised relationships were not statistically significant.

III) Domination of Independent and Non-Executive Director and Firm Performance (DONEDI) – OLS 1(iii)

Tables 7.5 and 7.6 respectively present the regression results derived from the OLS 1(iii)(a) [i.e. regression of DONEDI and specified board independence variables in 2002 with respective firm performance 2002 and 2003] and the OLS 1(iii)(b) research model [i.e. regression of DONEDI and specified board independence variables in 2003 with respective firm performance 2003 and 2004]. Specifically, OLS 1(iii) investigated the impact of domination of board of director combination by the sum of independent directors and non-executive directors (DONEDI: HBIND 3), proportion of independent directors with accounting and finance knowledge and skills (NINACF: HBIND 4), presence of a senior independent outside director (SRI: HBIND 5), the exclusion of Chief Executive Officer, Chief Financial Officer or Managing Director from membership of the board of directors (ECXEO: HBIND 6), the appointment of an independent director as the board of directors' chairman (CHINED: HBIND 7), the presence of a founder on the firm's board (FOUD: HBIND 8), the proportion of family directors on the board (NFAMDI:

HBIND 9) and the proportion of independent directors' shares' ownership (NINDSG: HBIND 10), on firm performance.

In Chapter 5, section 5.1.1, HBIND 3 proposed that the domination of board of director's composition by independent directors and non-executive directors (DONEDI) would have an impact on firm performance. OLS 1(iii)(a) and OLS 1(iii)(b) model results revealed no significant relationship between DONEDI and both market value and accounting-based performance measures.

For HBIND 5 testing, the results of OLS 1(iii)(a) and OLS 1(iii)(b) results [see Tables 7.5 and 7.6] indicated that, when board of director composition was dominated by independent directors and non-executive directors (DONEDI), the hypothesised relationship between the presence of a senior independent director (SRI) and firm performance held for two specific cases observed. However, there existed a significant positive relationship between SRI in 2002 and NROE in 2003 ($\beta = 0.31$; $p = 0.05$), and between SRI in 2003 and NROE in 2003 ($\beta = 0.30$; $p = 0.05$). These results were similar to those found in OLS 1(i)(a) and (b), and OLS 1(ii)(a) and (b) models where a significant positive relationship existed between SRI and firm performance.

In addition, OLS 1(iii)(a) and (b) results derived from testing HBIND 7 (see Tables 7.5 and 7.6) indicated that, when the board of director composition was dominated by independent directors and non-executive directors (DONEDI), the hypothesised positive impact of the presence of an independent chairman of the board (CHINED) on firm performance was supported by one particular case observed. Notably, there existed a significant positive relationship between

Table 7. 5: Board Independence and Firm Performance – OLS 1(iii)(a)

**The Examination of Domination of Independent and Non-Executive Directors on the Board (DONEDI) in 2002 with Respective Firm Performance 2002 and 2003
(The Testing of HBIND 3 with HBIND 4,5,6,7,8,9 and 10)**

BOD – Board of Directors, NROE – Return on Equity, DONEDI – Domination of Independent and Non Executive Directors, NINACF – Proportion of INEDs with accounting and finance background, SRI – Senior Independent Director appointment on BOD, EXCEO – Exclusion of CEO, CFO, COO and Managing Director, CHIN – Board's Chairman INED, FOUN – Founder presence on BOD, NFAMD1 – Proportion of family member directors, NINSDG – Equity holdings of INED, NASET – Total Assets, NDEQ – Debt to equity ratio, NINSTL – Total proportion of Government Agencies', Public Listed Companies', Corporations' and Other Institutions' substantial equity holdings, PROP – Property industry, CONSTR – Construction industry, FIN – Finance industry, 02 – Year 2002, 03 – Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All F statistical values were significant at 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2194		0.1391		0.2072		0.1398	
R ²	0.2939		0.2213		0.2829		0.2219	
F	3.9437		2.6931		3.7383		2.7019	
	Coefficient	Coefficient	Coefficient	t-stat	Coefficient	t-stat	Coefficient	t-stat
Intercept (α)	0.0288	-0.1308	-0.1103	-0.4771	-0.1330	-0.5994	-0.0969	-0.4189
<i>Explanatory Variables (β)</i>								
DONEDI02	0.0318	0.1918	0.0692	-0.3975	-0.0148	-0.0888	-0.0758	-0.4355
NINACF02	-0.0215	-0.3124	0.0574	0.7942	-0.0262	-0.3780	-0.0094	-0.1303
SRI02	-0.1844	-1.4373	0.1896	1.4075	-0.1049	-0.8113	0.3078	2.2858**
EXCEO02	0.1364	0.8692	0.1958	1.1879	0.1407	0.8894	0.1478	0.8970
CHIN02	0.0475	-0.2995	0.0390	0.2337	-0.0966	-0.6040	-0.1164	-0.6982
FOUD02	0.1661	1.0243	0.0896	0.5261	0.1602	0.9800	0.0101	0.0591
NFAMD102	0.1829	-1.9529*	0.0269	0.2739	-0.0963	-1.0198	0.0227	0.2310
NINSDG02	0.0449	-0.6249	-0.0477	-0.6328	-0.0427	-0.5897	0.1210	1.6051
<i>Control Variables</i>								
NASET02	-0.2494	2.4905**	0.4016	3.8184***	-0.2549	-2.5251**	0.2942	2.7986**
NDEQ02	0.1555	2.1411**			0.3112	4.2532***		
NINSTL02					0.2066	2.0637**		
<i>Industry Dummy</i>								
PROP	-0.9360	-4.1788***			-0.8156	-3.6131***		
CONSTR	0.4334	1.7111*			0.4966	1.9459*		
FIN					-0.6213	-2.3761**		

Table 7. 6: Board Independence and Firm Performance -- OLS I(iii)(b)

**The Examination of Domination of Independent and Non-Executive Directors on the Board (DONEDI) in 2003 with Respective Firm Performance 2003 and 2004
(The Testing of HBIND 3 with HBIND 4, 5, 6, 7, 8, 9 and 10)**

BOD - Board of Directors, NROE - Return on Equity, DONEDI - Domination of Independent and Non-Executive Directors, NINACF - Proportion of INEDs with accounting and finance background, SRI - Senior Independent Director appointment on BOD, EXCEO - Exclusion of CEO, CFO, COO and Managing Director, CHIN - Board's Chairman INED, FOUN - Founder presence on BOD, NFAMDI - Proportion of family-member directors, NINSDG - Equity holdings of INED, NASET - Total Assets, NDEQ - Debt to equity ratio, NINDPV - Total proportion of Individuals' and/or Private Companies' substantial equity holdings, NINSTI - Total proportion of Government Agencies', Public Listed Companies' Corporations' and Other Institutions' substantial equity holdings, PROP - Property industry, FIN - Finance industry, 03 - Year 2003, 04 - Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***)]. All F-statistical values were significant at 0.05 level]

Performance Measure	TOBIN'S Q 2003		ROE 2003		TOBIN'S Q 2004		ROE 2004	
Adj R ²	0.2377		0.1820		0.0700		0.1177	
R ²	0.3105		0.2601		0.1608		0.2039	
F	4.2670		3.3313		1.7702		2.3660	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.2293	1.0258	0.1578	0.6812	-0.2464	-0.9869	-0.2934	-1.2070
<i>Explanatory Variables (β)</i>								
DONEDI03	0.0441	0.2663	-0.2171	-1.2669	0.2530	1.3692	0.1857	1.0329
NINACF03	0.0783	1.1330	0.0311	0.4349	0.0219	0.2839	0.0510	0.6786
SRI03	-0.0813	-0.6718	0.2988	2.3841**	0.0621	0.4595	0.0248	0.1882
EXCEO03	0.1385	0.9953	0.2312	1.6039	0.0539	0.3467	0.1787	1.1810
CHIN03	0.1435	0.9318	0.2631	-1.6498	0.0854	0.4964	0.2875	1.7174*
FOUD03	0.1780	1.0377	-0.1245	-0.7004	0.2302	1.2016	0.0697	0.3738
NFAMDI03	-0.0385	-0.4188	-0.0184	-0.1930	-0.0691	-0.6724	0.0127	0.1266
NINSDG03	-0.0653	-0.9047	0.0369	0.4932	-0.1510	-1.8740*	0.0381	0.4857
<i>Control Variables</i>								
NASET03	-0.3325	-3.2437***	0.4306	4.0546***	-0.2035	-1.7771*	0.2724	2.4442**
NDEQ03	0.3350	4.7466***					0.1474	1.9212*
NINDPV03							0.1668	1.6597*
NINSTL03	0.2937	2.9112***					0.2296	2.0938**
<i>Industry Dummy</i>								
PROP	-0.7144	-3.2101***	-0.4115	-1.7849*	-0.5243	-2.1091**		
FIN	0.4859	1.8690*	-0.4656	-1.7291*	-0.5535	-1.9062*		

CHINED in 2003 and NROE in 2004 ($\beta = 0.29$; $p = 0.1$), similar to the OLS 1(i)(b) and (ii)(b) models finding of a significant positive relationship between the presence of an independent chairman of the board (CHINED) and firm performance.

On the other hand, when board of director composition was dominated by independent directors and non-executive directors (DONEDI), OLS 1(iii)(a) results derived from testing HBIND 9 (see Table 7.6) revealed a significant negative relationship between the proportion of family-member directors (NFAMDI) in 2002 and NTobin's Q in 2002 ($\beta = -0.18$; $p = 0.1$). This result was similar to significant findings of previous OLS 1(i)(a) and OLS 1(ii)(a) models, estimating the relationship between NFAMDI and firm performance.

With respect to HBIND 10 testing, the results of OLS 1(iii)(b) revealed that, when board of director composition was dominated by independent directors and non-executive directors (DONEDI), there existed significant negative relationship between NINSDG in 2003 and NTobin's Q in 2004 ($\beta = -0.15$; $p = 0.1$). This result was consistent with respective significant finding gathered by OLS 1(i)(b) and OLS 1(ii)(b) models earlier.

Furthermore, OLS 1(iii)(a) and OLS 1(iii)(b) results derived from testing HBIND 4, 6 and 8 indicated that, in all cases observed, the respective hypothesised relationships were not statistically significant. Similar findings were obtained by OLS 1(i) and OLS 1(ii) models for the testing of HBIND 4 and 8 relationships with firm performance.

In adherence, Table 7.7 summarises the findings derived from examining the impact of board independence on firm performance.

Table 7.7: Summary of Findings of the Impact of Board Independence on Firm Performance

<i>Board of Director's Independence and Firm Performance --- OLS 1</i>								
<i>Proportion of Independent Director</i>			<i>Domination of Independent Director</i>			<i>Domination of Independent and Non-Executive Director</i>		
<i>OLS 1(i)</i>	<i>Postulated Relationship</i>	<i>Result</i>	<i>OLS 1(ii)</i>	<i>Postulated Relationship</i>	<i>Result</i>	<i>OLS 1 (ii)</i>	<i>Postulated Relationship</i>	<i>Result</i>
<i>HBIND 1: Proportion of INEDs [NINED]</i>	<i>+</i>	<i>Not Supported</i>	<i>HBIND 2: Domination of INEDs [DOINED]</i>	<i>+</i>	<i>Not Supported</i>	<i>HBIND 3: Domination of INEDs and NEDs [DONEDI]</i>	<i>?</i>	<i>Not Supported</i>
<i>HBIND 4: Proportion of INEDs with ACF [NINACF]</i>	<i>+</i>	<i>Not Supported</i>	<i>HBIND 4: Proportion of INEDs with ACF [NINACF]</i>	<i>+</i>	<i>Not Supported</i>	<i>HBIND 4: Proportion of INEDs with ACF [NINACF]</i>	<i>+</i>	<i>Not Supported</i>
<i>HBIND 5: Presence of SRINED [SRI]</i>	<i>?</i>	<i>Positive Relationship</i>	<i>HBIND 5: Presence of SRINED [SRI]</i>	<i>?</i>	<i>Positive Relationship</i>	<i>HBIND 5: Presence of SRINED [SRI]</i>	<i>?</i>	<i>Positive Relationship</i>
<i>HBIND 6: Exclusion of CEO, CFO, COO and MD [EXCEO]</i>	<i>+</i>	<i>Supported</i>	<i>HBIND 6: Exclusion of CEO, CFO, COO and MD [EXCEO]</i>	<i>+</i>	<i>Supported</i>	<i>HBIND 6: Exclusion of CEO, CFO, COO and MD [EXCEO]</i>	<i>+</i>	<i>Not Supported</i>
<i>HBIND 7: Presence of Independent Board Chairman [CHIN]</i>	<i>+</i>	<i>Supported</i>	<i>HBIND 7: Presence of Independent Board Chairman [CHIN]</i>	<i>+</i>	<i>Supported</i>	<i>HBIND 7: Presence of Independent Board Chairman [CHIN]</i>	<i>+</i>	<i>Supported</i>
<i>HBIND 8: Presence of founder [FOUD]</i>	<i>?</i>	<i>?</i>	<i>HBIND 8: Presence of founder [FOUD]</i>	<i>?</i>	<i>?</i>	<i>HBIND 8: Presence of founder [FOUD]</i>	<i>?</i>	<i>?</i>
<i>HBIND 9 : Proportion of FAMDI [NFAMDI]</i>	<i>?</i>	<i>Negative Relationship</i>	<i>HBIND 9 : Proportion of FAMDI [NFAMDI]</i>	<i>?</i>	<i>Negative Relationship</i>	<i>HBIND 9 : Proportion of FAMDI [NFAMDI]</i>	<i>?</i>	<i>Negative Relationship</i>
<i>HBIND 10: Proportion of INEDs' shares ownership [NINSDG]</i>	<i>?</i>	<i>Positive/ Negative Relationship</i>	<i>HBIND 10: Proportion of INEDs' shares ownership [NINSDG]</i>	<i>?</i>	<i>Negative Relationship</i>	<i>HBIND 10: Proportion of INEDs' shares ownership [NINSDG]</i>	<i>?</i>	<i>Negative Relationship</i>

Notes: INED = Independent Director; NED = Non Executive Director; ACF = Accounting and Finance Knowledge and Skills, SRINED=Senior INED; CEO = Chief Executive Director; CFO = Chief Financial Officer, COO = Chief Operating Officer; MD = Managing Director; FOUD = Founder; FAMDI =Family-Member Director; BOD = Board of Directors

7.2.1.1 Discussions of the Impact of Board Independence on Firm Performance --- OLS 1(i), OLS 1(ii) and OLS 1(iii) Results

(I) Proportion of Independent Directors (NINED), Domination of Independent Directors (DOINED) and Domination of Independent and Non-Executive Directors (DONEDI).

As indicated in OLS 1(i), OLS(ii) and OLS (iii) regression results (see Tables 7.1, 7.2, 7.3, 7.4, 7.5 and 7.6], there was no significant relationship between the proportion of independent directors, the domination of independent directors and the domination of independent and non-executive directors and firm performance, in most of the cases observed. This result is consistent with the findings of Abdullah (2004) and Chang Aik Leng and Abu Mansor (2005) who found no significant relationship between the proportion of non-executive directors and firm performance. Moreover, changes in independent director composition on firms' board were mainly driven by MBSB Listing Requirements 2001 (see KLSE and PwC, 2002) which require the presence of minimum of 2 or one-third independent directors (whichever gives the highest number) on firm's board. Furthermore, when firms' Tobin's Q and ROE values were examined, there was a high percentage of firms with a Tobin's Q below 1 and a negative ROE between the period 2001 to 2004 (see Table 7.8).

Table 7.8: The Percentage of Firms with a Tobin's Q less than 1 and a Negative ROE Value

Category	Year			
	2001	2002	2003	2004
The percentage of firm's with a Tobin's Q less than 1	71.90%	69.20%	76.00%	63.40%
The percentage of firms with a negative ROE value	18.60%	20.80%	20.40%	16.20%
<i>N = 221 firms</i>				

CHAPTER 7: ANALYSIS & DISCUSSION 1 – BOD AND FIRM PERFORMANCE

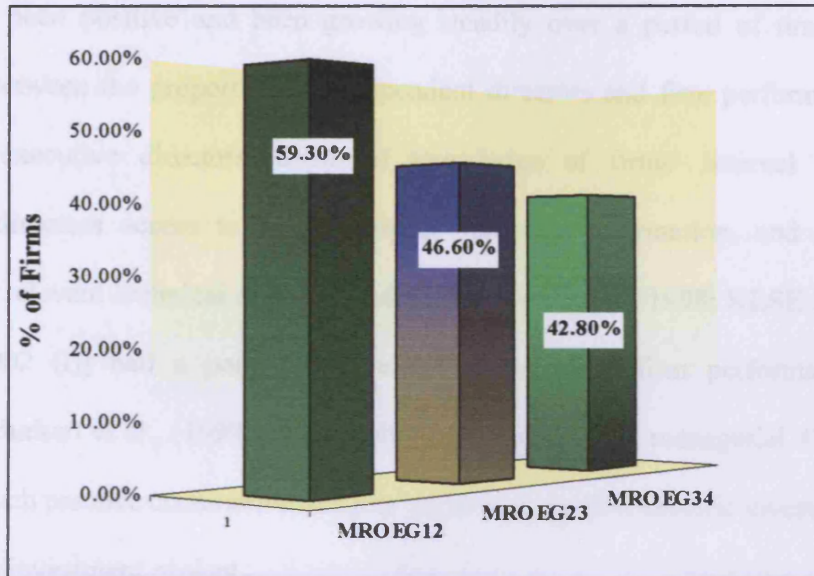
Notably, the practice of some firms to increase their board's independence with the appointment of more non-executive director⁶⁸ rather than independent directors should be questioned by the MBSB, since non-executive director can encompass family member, current or former employees and/or affiliated directors (see Bhagat and Black, 1999). Companies' assertions in their corporate governance statement in 2002 and 2003 that such action had led to the appropriate establishment of independent views and a fair representation of shareholders' interest on firms' board were misguided. Namely, Chang Aik Leng and Abu Mansor (2005) argued that, their lack of finding of a significant link between proportion of non-executive directors and return on equity was due to the lack of independence and hence monitoring commitment of non executive directors in Malaysian firms.

However in two observed cases, significant negative relationship were found between the respective proportion of independent directors in 2002 and 2003, and return on equity in 2003 [see OLS 1(i)(a) and (b), and OLS 1(ii)(a) results in respective Table 7.1, 7.2 and 7.3]. This finding was consistent with that reported by Agrawal and Knoeber (1996) and Yermack (1996) who found a negative relationship between the proportion of independent directors and firm performance. Further examination of firms' appointment of independent directors in 2003 (see Chapter 6, Table 6.14) indicated an increase in the proportion of independent directors on boards in 2003. The cited result seemingly implies that the higher presence of independent directors had not contributed to higher firms' earnings. In addition, when firms' ROE growth and ROE values were referred (see Graphs 7.1 and 7.2 respectively), there were high percentage of the sampled firms that had experienced negative ROE growth and value.

⁶⁸ As indicated by some of the sample companies in their corporate governance statement, specifically when they were discussing about their board's independence composition and establishment of appropriate impartial views in the board of director.

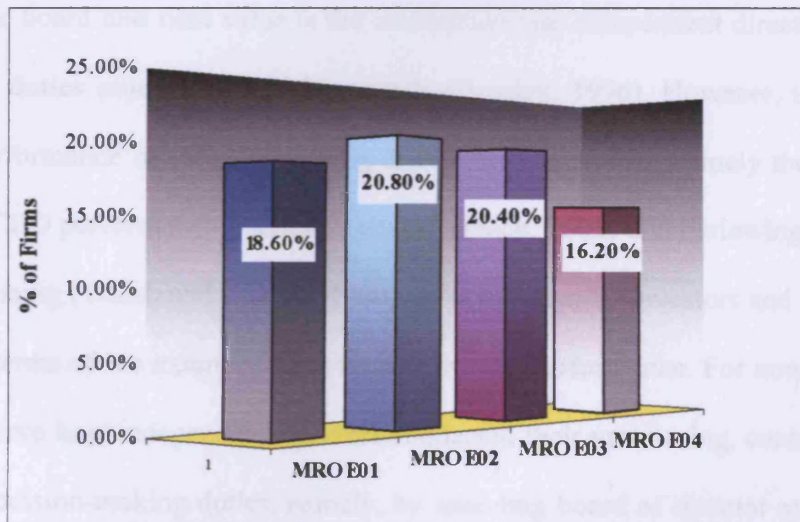
Graph 7.1: Percentage of Firms with Negative Return on Equity Growth (MROE) between the Period 2001 to 2004

(Notes: MROEG12= Firms with negative ROE Growth between Year 2001 and 2002; MROEG23= Firms with negative ROE Growth between Year 2002 and 2003; MROEG34= Firms with negative ROE Growth between Year 2003 and 2004)



Graph 7.2: Percentage of Firms with Negative Return on Equity Value between the Period 2001 to 2004.

(Notes: MROE01= Firms with negative ROE in 2001; MROE02= Firms with negative ROE in 2002; MROE03= Firms with negative ROE in 2003; MROE04= Firms with negative ROE in 2004)



Possibly the negative relationship between the proportion of independent directors in 2002 and 2003, and NROE in 2003 respectively were due to companies having had a series of negative earnings in past years. A potentially positive relationship between proportion of

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independent directors and return on equity would have been observed if respective firms' earnings had been positive and been growing steadily over a period of time. The negative relationship between the proportion of independent directors and firm performance could also signify that executive directors' depth of knowledge of firms' internal operations, and independent directors access to firms' current operating information, and board members possession of relevant technical expertise [Muth and Donaldson, 1998; KLSE and PwC, 2002; McKinsey 2002 (i)] had a potentially greater influence on firm performance. Moreover, according to Burkart et al., (1999) high monitoring imposition on managerial discretion may be costly when such practice constraint managers' initiatives on firm specific investment, namely in searching new investment project.

Besides that, underlying the link between the proportion or higher influence of independent directors on the board and firm value is the assumption that independent directors will perform their oversight duties objectively and impartially (Beasley, 1996). However, the extent of the appropriate performance of their monitoring and controlling duties, namely their evaluation of company and CEO performance (Hermalin and Weisbach, 2001) and reviewing of management succession planning (Walsh and Seward, 1990) are not known by investors and are also difficult to quantify in terms of the extent of their impact on firm performance. For non-board members to directly observe how independent directors conducted their monitoring, controlling, advisory and strategic decision-making duties, namely, by attending board of director meetings may not have been allowed by firms due to the confidentiality of their business information (see Spira, 1998).

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Thus, the use of the proportion of independent directors or their domination on the board in regression models may not be able to accurately convey such directors' performance of oversight duties and this may explain the non-existent link between the proportion of independent directors and firm performance. Bhagat and Black (1999) in their study examining the impact of board independence composition on the performance of directorial tasks, namely CEO replacement or acquisition of a company, gathered that such independence composition may not be able to capture directors' oversight influence on overall organisational performance.

In addition, according to Robinson Jr. (1992), board members' active involvement in the firm's strategic decisions will enhance company and management credibility. Consequently, when independent directors do not participate actively in the firm's strategic planning and investment setting, their conduct would not contribute to fair representation and protection of shareholders' interest and hence better firm performance (Ireland and Hitt, 2005). Namely, the lack of significant relationship observed between board independence composition (i.e. NINED, DOINED and DONEDI) and firm performance, may also due to inappropriate measure use to examine independent director participation in the firm's strategic decision-making process.

Moreover, the findings of KLSE and PwC 2002 survey indicated that, the independent director effectiveness is affected by their ease of access to the firm's internal information. Given the separation of independent directors' duties from day to day or operational responsibilities [see Fama and Jensen 1983 (a); Baysinger and Hoskisson, 1990], their ability to appropriately assess and advise the firm about its current state of operational or financial circumstances requires the availability of relevant information and consultation with external independent professional

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advisors. MBSB Listing Rulings require firms to ensure that their board members have access to internal sources of information, including firms' employees co-operation, as well as the means for obtaining external professional advice, since these will enhance board members' accountability when performing their oversight duties. From the review of firms' corporate governance statements in this study, some companies restricted their board members from obtaining outside consultation advice since they argued their internal human resources were sufficient to assist their board members.

On the other hand, some companies set the amount of funds that could be spent on the services of external professional advisors (as stated in some of the companies' corporate governance statement). Firms' restriction of funds available to obtain outside experts' advice, is another obstacle to independent directors' effectiveness in making informed economic judgements, given their limited skills and knowledge of the firm' risks and operations. Board members' sole reliance on the firm's internal sources and assistance may affect the quality of their oversight, namely, their assessment of management's strategic investment planning proposals. Ezammel and Watson (1998) raised the issue of the accountability of management information supply since they argued that the internally supplied information could be biased and likely to support management discretion.

Further, in most companies' corporate governance statement in this study, companies indicated their preference to establish a board of directors comprising a variety of human capital knowledge and skills, namely, a mix of directors with financial and non-financial skills. Studies by Kirk and Siegel (1996) indicated that the influence of audit committee opinion on the firm's

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financial reporting practice and circumstances will be stronger when there is the presence of at least one board member with financial background but not an audit committee member. Potentially, independent directors' judgements of the firm's financial position may be affected by the lack of financial experts' presence on the firm's board.

In Chapter 7 of MBSB Listing Requirements, board of directors and managing directors are required to retire at least once in every 3 years. It was noted from companies' 2002 and 2003 annual reports that, in most cases, the senior director of the company was the one re-elected or retired on a rotational basis. Potentially the dynamics of the board team may be affected by the changes in board composition especially in the case of newly appointed directors who may need the guidance of an experienced director to perform their job (see Baysinger and Butler, 1985).

In addition, the appointment of new independent directors may have an impact on the quality of oversight duties performed in the firm, as their understanding, experience and capability to perform their oversight responsibilities will take time to develop and subsequently influence firm performance (see Demsetz and Lehn, 1985; Barnhart and Rosenstein, 1998; Yermack, 2004). Moreover, as Bhagat and Black (2002) pointed out, it was difficult to assess board members contribution when they were likely to be replaced within a short space of time. On the other hand, the need to educate and increase board members' awareness of their responsibilities has been noted by the MBSB, since in its Listing Ruling 2001 it requires listed firms to send their directors to attend Mandatory Accreditation Programme ("MAP")⁶⁹ training [organised by the Research Institute of Investment Analysis of Malaysia ("RIIAM")]. Even though

⁶⁹ This requirement was not mandatory beginning 1st January 2005, where the board of director of firms are given full responsibility to ensure that their directors have obtained sufficient training required for the performance of their duties [see MBSB, 2004(iii)]

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examination of the impact of the proportion of independent directors or their high composition on firm performance has not produced a significant result, Barney et al., (2001) argued that implementation of the internal corporate governance mechanism should be undertaken appropriately to fully realise its benefit in governing firms' resources and management. Similarly, Bhagat and Black (1999) pointed out that a firm's competitive advantage is much affected by its identification of the appropriate board of director composition for its business.

The lack of significant result gathered on the relationship between high board independence and firm performance would appear to support Vance (1964) and Fama (1983) propositions. They posited that executive directors' greater knowledge and experience of the firm operations than outside directors, allow them to make better informed strategic decision making for the firm and consequently this can result in better firm performance.

A more wholesome approach to examining independent board members' effectiveness in performing their oversight duties and the subsequent contribution of it to firm performance could be undertaken with the investigation of their contribution and involvement in the advisory, strategic and monitoring duties (see Dulewicz and Herbert, 2004). In particular, this will require the identification of the tasks that they perform in each of these respective duties. Furthermore, the linking of the composition of independent directors on the board with firm performance may not be representative of their actual involvement in board activities. Notably, such relationship is based on the underlying assumption that given certain governance qualities of outside independent directors they should be able to monitor and control management activities that are detrimental to firm value.

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The background of an independent director as someone from outside the firm and who has no association with the firm's management activities, underlie his/her suitability to conduct board decision-making objectively and hence his/her capability to fairly represent shareholders' best interests. However, to what extent do the independent directors' opinions and actions influence board decision-making so as to influence firm performance? Potentially, research should be undertaken to identify the responsibilities performed by the independent director on the board and subsequently to measure the extent and impact of such conduct on the firm strategic direction. This may provide a useful insight into outside independent directors' contribution to firm value. In other words, as well as being independent from management, outside directors also need to possess good leadership, management and entrepreneurial knowledge and skills to positively influence firm value creation. According to Main et al., (1996) board decisions are made collectively and hence the involvement and cooperation of each board member are important to attain dynamic judgement.

On the other hand, the effectiveness of independent directors' governance conduct may be compromised by their need to secure future employment in the company, and to ensure long-term service, and for these reasons they may be pressured to approve certain management plans [see Shivdasani and Yermack, 1999; Cheah, 2003]. Namely, according to Mohamed Abdullah (2003), since independent directors are employed by the company they may not be entirely independent from management. Besides that, even though the directors' appointment and choice of candidates have to meet with the approval of shareholders, the CEO's choice of directors still presides [see Hermalin (1991); Bathala and Rao (1995)].

In addition, firms need to be responsible for their implementation of regulatory requirements pertaining to corporate governance practice by enforcing them properly and not merely complying with the rules. In other words they need to recognise the significance of independents' director human capital by utilising such directors' external knowledge and skills efficiently to create firm value (see Fama and Jensen, 1983; Uzzi, 1996; Short et al., 1998). In addition, Schroeder et al., (1967) argue that a person's educational level has an impact on their ability to process complex information. As indicated in Chapter 6 Table 6.21 many of the 221 Malaysian firms' board members possessed higher educational background. Also, many of the firms had appointed board members with public and private sector experience.

In addition, Fredrickson et al., (1988) noted that the independent director vigilance initiatives may be compromised by their personal ties with management. To ensure the reliability of independent director's impartial opinions and judgments in the board, Mohammed Abdullah (2003) proposed for their appointment in the company to be administrated by a separate body other than the company. This practice would establish quality independent director where the director would not feel oblige to follow management command since their employment are not determined by them.

(II) Independent Directors' Accounting and Financial Knowledge and Skills (INACF)

As regards to the impact of the proportion of independent directors with accounting and finance background on the firm performance it was not significant when analysed together with the proportion of independent directors, the domination of independent directors and the domination of independent and non-executive directors on the board. According to Castanias and Helfat

(1991, 2001), entrepreneurship skill is one of several important human capital resources that can generate a firm's rents. Potentially, independent directors' accounting and financial skills may be relevant for their performance of monitoring and controlling duties, such as financial oversight and risk assessment. On the other hand, independent directors' entrepreneurship skills will have more influence on the firm's strategic decision-making and competitive advantage and, subsequently, performance when such directors participate actively in the strategic decision-making process (see Barney et al., 2001; KLSE and PwC, 2002).

(III) Senior Independent Director (SRINED)

The appointment of a senior independent director on the board of the firm is one of the MCCG (2001) Best Practices guidelines and hence is a voluntary practice. From OLS (i), OLS (ii) and OLS (iii) results (see Tables 7.1 to 7.6 respectively), there existed significant positive relationship between the presence of a senior independent director (SRINED) and firm performance in all three cases of board independence observed (i.e. proportion of independent directors, the domination of independent directors and the domination of independent and non-executive directors on the board). This finding supported Knapp (1987), Hampel Committee (1998), De Zoort and Salterio, (2001), MCCG (2001) and Higgs Report (2003) recommendations that a senior independent director be appointed to the firm's board. Further analysis of the relationship between senior independent director appointment and proportion of independent directors on the board of director (see Table 7.9) revealed a high statistically significant association between the two respective variables. Pearson Chi-Square results further supported the significant relationship between senior independent director and firm performance in the three cases of board independence observed.

Table 7.9: Pearson Chi-Square Estimates of the Degree of Association between Senior Independent Director (SINED) Appointment and Proportion of Independent Directors on the Board

(Notes: SINED=Senior Independent Director; INED = Independent Director; INLSBD= INED proportion less than 1/3; INRDBD = INED proportion is 1/3; INGRDBD = INED proportion greater than 1/3 but less than 50%; IN50BD = INED proportion is 50%; ING50BD = INED proportion greater than 50%; ***, ** and * respectively represents the significance level of 0.001, 0.05 and 0.1)

Category	Pearson Chi-Square Value	
	Yr 2002	Yr 2003
<i>SINED x INLSBD</i>	29.125***	21.260***
<i>SINED x INRDBD</i>	40.241***	27.851***
<i>SINED x INGRDBD</i>	38.640***	49.787***
<i>SINED x IN50BD</i>	17.336***	17.459***
<i>SINED x IG50BD</i>	11.775**	13.766***
Number of Firms	98	106

Potentially, companies with a proportion of independent directors less than 50% were likely to appoint a senior independent director to enhance the quality of their board’s independence, credibility, and to strengthen the influence of independent directors’ views, decisions and their need for information, given their less than majority numbers on the board. Moreover, the minority proportion of independent directors on the board might further require the influence of a high reputation and competent independent director (i.e. the senior independent director) to establish and strengthen the materiality of their views. Furthermore, the appointment of a senior independent director on the board of firms which have not fulfilled the minimum requirement of independent director presence in the board was critical to protect the interests of shareholders. In addition, companies with less than one-third independent director presence responded in their corporate governance statement that the appointment of senior independent director to their board of directors would ensure reliability and sufficiency of independent views in the board decision making process.

As regards to firms with an INED proportion of 50% or more, companies explained in their corporate governance statement that the appointment of a senior INED was due to their recognition of the value and contribution of this director in establishing appropriate and sufficient governance measures in their companies.

(IV) Exclusion of CEO, CFO, COO and/or Managing Director from Board's Membership (EXCEO)

The exclusion of top management officers (i.e. CEO, CFO, COO and/or managing director) from board membership in 2003 produced a significant positive relationship with return on equity 2003 and 2004 (see results in Tables 7.2 and 7.4). These findings were observed in the two cases of board independence examined (i.e. proportion of independent director and the domination of independent directors). In particular the findings supported the argument that the presence of the CEO on the board may limit independent directors' freedom to express their independent view or challenge management decisions that are in conflict with shareholders' interests (Kosnik, 1987). The findings were consistent with Walsh and Seward's (1990) argument that high board independence will ensure independent director effectiveness in administrating the firm. Furthermore, CEO dominant influence on board members appointment, remuneration and term of office may constrain independent directors' governing initiatives (Daily and Johnson, 1997; Shivdasani and Yermack, 1999). In addition, Ryan Jr. and Wiggins III (2004) argued that independent boards are more willing to monitor the CEO because the high presence of independent director on the board will reduce the CEO's influence and ability to determine their term of service exclusively. However, the study finding was in contrary to

Bhagat and Black's (1999) observation of CalPERS⁷⁰ identification of an ideal board of directors composition to include a CEO amongst other non-executive director board members.

(V) Independent Board's Chairman (CHINED)

A significant positive relationship was found between the presence of an independent board chairman in 2003 and ROE 2004 (see OLS 1 results in Tables 7.2, 7.4 and 7.6]. Notably, the influence of independent directors (i.e. proportion of independent directors, the domination of independent directors and the domination of independent and non-executive directors on the board) will be enhanced when the board's chairman is one of them. This result is consistent with the finding reported by Coles and Hesterly (2000) who found a positive relationship between the presence of an independent board chairman and market reaction to firm adoption of poison pill⁷¹ which was measured by the firm's cumulative abnormal return. An independent board chairman, as well as being the board's leader, has control and authority to influence organisational processes (Eisenhardt and Schoonven, 1990).

Moreover, as the board's leader, the independent board chairman has the capability to monitor, control and discipline management activities strategically on shareholders' behalf (Kose and Senbet, 1998). In addition such board chairman's duties include the setting of the board's agenda, monitoring of board subcommittee's and convening stockholders' meetings (Sundaramurthy et .al., 1997:233).

⁷⁰ The California Public Employees Retirement System

⁷¹ Mechanism that can be used by a target firm in a takeover contest to extract a larger premium from the bidding firm (Coles and Hesterly, 2000:197)

Accordingly, Malaysian companies in their corporate governance identified the board chairman's primary role to include:

- (i) Ensuring orderly conduct and working of the Board,
- (ii) Providing a broader view and independent judgement on issues of strategy, performance and resources, including key appointments and standards of conduct thus ensuring that the long-term interests of shareholders are being looked after,
- (iii) Leading the Board and planning board meeting(s) agendas,
- (iv) Providing clarification on issues raised by shareholders and investors at the company's general meetings
- (v) Ensuring the smooth running of the Board, such as the effective functioning of the Board, balance of membership on the Board, that all the relevant issues are on the board meeting agendas and all directors timely receive relevant information before deliberations at the board meetings.

(Source: The Malaysian Listed Companies' Annual Report of 2002 and 2003)

(VI) The Presence of Founder (FOUD)

As indicated by OLS 1 regression results (see Tables 7.1 to 7.6) there was no significant relationship between the presence of founder and firm performance when it was examined respectively with the proportion of independent directors, the domination of independent directors and the domination of independent and non-executive directors on the board. According to Villalonga and Amit (2006) founder presence on the board will add value to the firm when he/she holds the position of the firm's CEO or board chairman where the CEO is not a family member of the founder. In the current sampled firms in this study, founder was rarely the firm's CEO or board chairman (see Chapter 6, Table 6.18). These reasons may explain the non-significant results gathered between FOUD and firm performance.

(VII) Proportion of Family-Member Directors (NFAMDI)

OLS 1(i)(a), OLS 1(ii)(a) and OLS 1(iii)(a) results [see Tables 7.1, 7.3 and 7.5 respectively] indicated that there exists significant negative relationship between the proportion of family directors on the board and firm performance. According to Jaggi and Leung (2007), the higher presence of family-member directors on the firm's board may affect the ease and ability of independent director to conduct their oversight duties objectively and impartially. In particular, they noted that family-member directors' preference for their family members' directorship on the firm's board will influence the prospective appointment of independent director on the board. McConaughy et al., (1998) further gathered, family-members strengthen their dominant influence over board decisions by exercising their dominant voting rights (given their high ownership of the firm's shares) to insist on the appointment of their family members to the board. Moreover, Claessens et al., (1999, 2000) and Mitton (2002) linked the presence of owner-managers to the greater potential of minority interests' expropriation. Besides that, business culture being practised by family members has a potential impact on the reliability of firm performance (see Sørensen, 2002).

(VIII) The Proportion of Independent Director Equity Shareholdings

In most of the cases observed, the results of OLS 1 (see Tables 7.1 to 7.6) indicated no significant relationship between independent directors' equity holdings and firm performance. Specifically, a significant positive relationship was found between independent directors' equity holdings in 2002 and return on equity in 2003 (see Table 7.1). On other the other hand, the results of OLS 1(i)(b), OLS 1(ii)(b) and OLS 1(iii)(b) [see Table 7.2, 7.4 and 7.6 respectively] revealed a significant negative relationship between independent directors' equity holdings in

2003 and Tobin's Q 2004. Potentially, investors' awareness of quality corporate governance will develop overtime and they may have certain expectations on independent directors' contribution in monitoring and strengthening firm's governance practice. In the case of the current study, the lack of performance of independent directors may have influenced investors, evaluation of the economic value of the firm shares in the later years.

In addition, according to Yermack (2004) equity holdings is one of the potential sources of motivation or discipline for an individual director. In particular, Malette and Fowler (1992) found that, the effectiveness of equity holdings as a monitoring incentive for independent directors depends on directors' holdings of substantial shares in the firm. Similarly, Finkelstein and Hambrick (1996) and Conyon and Peck (1998) noted an association between the low equity holdings of independent directors and independent directors lack of vigilance and monitoring capability and incentives. As shown in Table 7.10, most of the independent directors in the sampled firms owned less than 2% equity in the company.

Table 7.10: The Distribution of Independent Director Shareholdings in the Year 2002 and 2003

	0%	Less Than 2%	Within 3%	Within 4%	15%
Year 2002	95	119	3	3	1
Year 2003	105	111	2	3	0
<i>N = 221 firms</i>					

Evidence of lower amounts of equity holdings by independent directors has also been noted by Lee et al., (1992). In the case of Malaysia, the MBSB Listing Rulings stipulate that independent directors should not be a firm's major shareholders and hence should not own 5% or more shareholdings in the firm (see MBSB Listing Requirements 2001: Para 1.01 on independent

directors and major shareholders). Moreover, according to PwC (2005), stock options plans are still not a common remuneration payment offered to board members. Even though, some firms do remunerate their executive directors and managing directors in the form of stock options. Importantly, Malaysian listed companies need to establish other types of financial incentive scheme to motivate independent directors' commitment to their oversight responsibilities' performance.

(X) Control Variables

OLS 1 results in Tables 7.1 to 7.6 suggested, there were other factors that may have influenced the level of firm performance. This was consistent with Yermack's (1996) argument that there are other corporate attributes that may affect firm value. Notably firm size such as measured by firm's total assets (**NASET**) had a significant negative relationship ($p = 0.01$ or $p = 0.05$) with Tobin's Q in most of the cases observed. This finding was similar to that reported by Drobetz et al., (2004) and Black et al., (2006) who found a negative relationship between firm's total assets and firm's Tobin's Q level. According to Conyon and Peck (1998), the relationship between firm size and firm performance reflects the extent of firms return given the complexity of their operations. In particular, the potential high growth rate of listed firms indicated their likelihood of acquiring more intangible assets [Drobetz et al., (2004:290)]. Further, Black et al., (2006) argued that due to the complexity of large firms' operations and the correspondingly large number of business transactions they will have to deal with in the deployment of their assets, they need to conform to certain procedures, namely to obtain the board's approval and other internal control procedures when undertaking their investment activities.

The use of leverage ratio, namely, debt to equity ratio, as a control variable of firm performance was consistent with the approach of Drobetz et al., (2004) and Black et al., (2006). In terms of firms' debt to equity ratio (**NDEQ**), in most cases the OLS 1 results indicated a significant positive relationship (i.e. $p = 0.01$ or $p = 0.05$) between firms' leverage and firms' performance (see Tables 7.1 to 7.6). In other words, the higher the firm's debt financing the higher is the firm's value. This could be explained by the effective monitoring by banks and/or financial institutions of firms' activities, which may result in firms' investment in value enhancement projects (Chang Aik Leng and Abu Mansor, 2005). Moreover, according to Friend and Lang (1998), the substantial investment of non-managerial principal shareholders in the firm will provide them with the appropriate incentive to monitor and influence management activities appropriately. In their view, the presence of substantial shareholdings of non-managerial principal shareholders provides a reliable governing mechanism. In addition, Friend and Lang (1998) indicated that, the influence of non-managerial investors may restrict managers' ability to adjust the firm's debt ratio and an anticipated high debt ratio will provide better governance of shareholders' interests.

With respect to the impact of independent and non-executive directors' total remuneration (**NNREMU**) on firm performance, OLS 1 results in Table 7.4 reported a significant positive relationship ($p = 0.1$) between the two variables. This finding suggested that the monitoring incentive of independent and non-executive directors can be enhanced with the setting of appropriate remuneration payments. In particular, Hirshleifer and Thakor (1994) and McKinsey [2002(i)] noted that directors' incentive alignment has an impact on their performance. Main et al., (1996) found a strong association between boardroom pay and firm performance when board

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members' compensation also encompassed share option schemes. In addition, KLSE and PwC's 2002 survey found that independent directors in Malaysian listed companies were concerned about their low remuneration payments. Companies' revision of the directors' compensation level in accordance with the market price for their service will provide an effective monitoring incentive, namely, independent directors' vigilance in their oversight duties.

OLS 1 results further revealed a significant positive relationship ($p = 0.01$; $p = 0.05$; $p = 0.1$) between the presence of particular substantial shareholder groups in the firm and firm performance. Specifically, this relationship was observed for both the presences of individuals and/or private companies equity holders (**NINDVL**) [see Tables 7.4 and 7.6] and institutional investors, namely government agencies, public listed companies/corporations and other institutions such as trust funds agencies (**NINSTL**) [see Tables 7.1 to 7.6]. Given the respective shareholder groups substantial equity holdings in the firm they had the motivation to exert a certain degree of monitoring of the firm's management and activities (see Friend and Lang, 1998).

Moreover, the significance of institutional shareholders participation in firm's economic decisions has been emphasised by MCCG (2001). Namely, firms are encouraged as part of best practices of corporate governance to establish appropriate channel to assist direct dialogue and communication between management, board of directors and the institutional investors. In terms of the responses of the companies, most of the sampled firms in this study supported the importance of institutional investors' direct communication with them [see the corporate governance statement of the companies on the discussions of their relationship with

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shareholders]. It was further gathered that, some of the sampled companies have taken the initiatives to establish investors' relations policy and report to enhance the integrity, conduct and transparency of their business.

On the other hand, the holding of large and diverse investment portfolios by government and institutional investors may also explain their equity holdings' insignificant impact on firm performance in other cases observed (see Lipton and Lorsch, 1992). Such circumstances may constrain government agencies' and institutional investors' abilities to inspect in detail and govern closely their investments in different companies.

In terms of the firm's industry's impact on firm performance, there existed significant negative relationship between the respective property (**PROP**) and finance (**FIN**) industry, and firm performance ($p = 0.01$; 0.05 ; $p = 0.1$) [see Tables 7.1 to 7.6]. On the other hand, construction industry (**CONSTR**) [see Tables 7.1 to 7.6] had a significant positive relationship with firm performance ($p = 0.01$ or $p = 0.1$). According to Bromiley (1991), industry performance has an impact on a firm's risk and hence performance. Ryan Jr. and Wiggins III (2004) used industry dummy to ensure the robustness of their empirical study of the impact of directors' compensation on their monitoring activity. Similarly, Hermalin and Weisbach (1991) employed industry dummy to capture the factor that may not affect managerial performance. As indicated by OLS 1 results, firms in the property industry may be experiencing a decline in profit due to the slow growth of the industry (see Eight Malaysian Plan, 2001-2005). With respect to the finance industry, the unsustainable growth in loans level particularly from property and equity market may have exposed the banking institutions to certain credit risks (see Eight Malaysian

Plan, 2001-2005). On the other hand, the high market value and earnings of firms in the construction industry could be due to its steady growth throughout a certain period of time (see Eight Malaysian Plan, 2001-2005). With respect to firms' governance practice's impact on firm performance, the decline or increase in the respective firms' performance may be by the result of the circumstances affecting their industry.

7.2.2 *Board Leadership and Firm Performance – OLS 2*

As discussed in Chapter 5, section 5.1.2, the impact of board of director leadership on firm performance was examined by OLS 2(i), OLS 2(ii), OLS 2(iii), OLS 2(iv), OLS 2(v) and OLS 2(vi) research models. Specifically, each model examined the impact of the appointment of an independent and non-independent director as the board's chairman and the separate appointment of the CEO and board's chairman on firm performance. The main explanatory variables in the OLS 2 model were the presence of an independent director as the board's chairman (CHINED), senior independent director as the board's chairman (CHSINED), founder as the board's chairman (CHFOUND), non-executive director as the board's chairman (CHNED), family-member director as the board's chairman (CHFAMDI) and separate appointment of the CEO and the board's chairman (SEPCEO). The examination of the impact of CHFOUND and CHFAMDI on firm performance was extended with the observation of the impact of SEPCEO in each respective model. The following subsections discuss the six OLS 2 models.

I) **Independent Director as the Board's Chairman (CHINED) and Firm Performance – OLS 2(i)**

Tables 7.11 and 7.12 respectively present the regression results derived from the research model OLS 2(i)(a) [i.e. regression analysis of CHINED and specified board leadership independent variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 2(i)(b) [i.e. regression of CHINED and specified board leadership variables in 2003 with respective firm performance 2003 and 2004]. Specifically, OLS 2(i) investigated the impact of an independent director as the board's chairman (CHINED: HBL 1) on firm performance.

In particular, HBL 1 proposed that the appointment of an independent director as the board's chairman (CHINED) will have a positive impact on firm performance (See Chapter 5 section 5.1.2). OLS 2(i)(a) and OLS 2(i)(b) results derived from testing HBL 1 indicated that, the hypothesis was supported by one specific observation. Namely, there existed a significant positive relationship between CHINED in 2003 and NROE in 2004 ($\beta = 0.28$; $p = 0.1$).

Table 7. 11: Board Leadership and Firm Performance – OLS 2(i)(a)
The Appointment of an Independent Director as the Board’s Chairman (CHINED) in 2002 and Firm Performance 2002 and 2003
(The Testing of HBL 1)

CHINED = Board’s chairman is independent director, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies’, Public Listed Companies/Corporations’ and Other Institutions’ substantial equity holdings, PROP = Property industry, CONSTR= Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003. A letter N at the front of respective variable’s acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (), 0.05 (**), 0.01 (***)]; All F statistical values were significant at the 0.001 level]*

Performance Measure	NTOBIN’S Q 2002		NROE 2002		NTOBIN’S Q 2003		NROE 2003	
Adj R ²	0.2346		0.1476		0.2273		0.1360	
R ²	0.2937		0.2135		0.2870		0.2028	
F	4.9655		3.2415		4.8065		3.0377	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0329	-0.2067	-0.0044	-0.0263	-0.1466	-0.9173	0.0203	0.1201
<i>Explanatory Variables (β)</i>								
CHINED02	-0.1021	-0.7098	-0.0188	-0.1239	-0.1575	-1.0894	-0.0954	-0.6242
<i>Control Variables</i>								
NASET02	-0.2975	-3.2758***	0.3776	3.9405***	-0.2705	-2.9643***	0.3287	3.4073***
NDEQ02	0.2063	2.9631***			0.3490	4.9895***		
NFAMDI02	-0.1786	-2.2712**						
NFORS2	0.2129	2.3142**			0.1880	2.0337**		
NINSTL02					0.1844	1.8317*		
<i>Industry Dummy</i>								
PROP	-0.8862	-3.9483***			-0.7582	-3.3625***		
CONSTR	0.4341	1.7551*			0.5024	2.0213**		
FIN					-0.5108	-1.9800**		

Table 7. 12: Board Leadership and Firm Performance – OLS 2(i)(b)
The Appointment of an Independent Director as the Board's Chairman (CHINED) in 2003 and Firm Performance 2003 and 2004
(The Testing of HBL 1)

CHINED = Board's chairman is independent director, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR= Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All F statistical values were significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2641		0.1912		0.0580		0.1242	
R ²	0.3210		0.2537		0.1325		0.1934	
F	5.6443		4.0587		1.7792		2.7934	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1109	-0.7045	0.1122	0.6801	0.0802	0.4455	-0.1057	-0.6092
<i>Explanatory Variables (β)</i>								
CHINED03	-0.0043	-0.0299	-0.1795	-1.1997	-0.0509	-0.3116	0.2796	1.7778*
<i>Control Variables</i>								
NASET03	-0.3471	-3.8751***	0.4098	4.3640***			0.2229	2.2575**
NDEQ03	0.3411	5.0278***					0.1560	2.0851**
NINED03	0.1465	2.2314**	-0.1493	-2.1696**				
NFORS3	0.1952	2.1801**						
NINSTL03	0.2676	2.6617***					0.2337	2.1088**
<i>Industry Dummy</i>								
PROP	-0.6887	-3.1654***			-0.5246	-2.1077**		
CONSTR							-0.4861	-1.8225*
FIN					-0.4957	-1.7430*		

II) Senior Independent Director as the Board's Chairman (CHSINED) and Firm Performance – OLS 2(ii)

Tables 7.13 and 7.14 respectively present the regression results derived from the research model OLS 2(ii)(a) [i.e. regression analysis of CHSINED and specified board leadership independent variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 2(ii)(b) [i.e. regression analysis of CHSINED and specified board leadership variables in 2003 with respective firm performance 2003 and 2004]. Specifically OLS 2(ii) investigated the impact of the appointment of a senior independent director as the board's chairman (CHSINED: HBL 2) on firm performance.

Namely, HBL 2 (see Chapter 5, section 5.1.2), hypothesised that the appointment of a senior independent director as the board's chairman (CHSINED) will have a positive impact on firm performance. OLS 2(ii)(a) and (b) results pointed to the contrary. The relationship between CHSINED and firm performance was not statistically significant both in terms of market value (NTobin's Q) and accounting-based measures (NROE) of firm performance.

Table 7. 13: Board Leadership and Firm Performance – OLS 2(ii)(a)
The Appointment of a Senior Independent Director as the Board's Chairman (CHSINED) in 2002 and Firm Performance 2002 and 2003
(The Testing of HBL 2)

CHSINED = Board's chairman is senior independent director, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR= Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_U); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All t-statistical values were significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2340		0.1476		0.2248		0.1358	
R ²	0.2932		0.2135		0.2847		0.2026	
F	4.9540		3.2407		4.7525		3.0341	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0394	-0.2492	-0.0061	-0.0367	-0.1595	-1.0020	0.0149	0.0889
<i>Explanatory Variables (β)</i>								
CHSINED02	-0.3104	-0.6045	-0.0390	-0.0720	-0.3755	-0.7268	-0.3183	-0.5835
<i>Control Variables</i>								
NASET02	-0.2879	-3.1862***	0.3792	3.9779***	-0.2565	-2.8220***	0.3378	3.5198***
NDEQ02	0.2025	2.9250***			0.3425	4.9170***		
NFAMDI02	-0.1745	-2.2278**						
NFORS2	0.2101	2.2847**			0.1836	1.9854**		
NINSTL02					0.1705	1.6673*		
<i>Industry Dummy</i>								
PROP	-0.8744	-3.8879***			-0.7430	-3.2836***		
CONSTR	0.4287	1.7283*			0.4979	1.9954**		
FIN					-0.4973	-1.9285*		

Table 7. 14: Board Leadership and Firm Performance – OLS 2(ii)(b)
The Appointment of a Senior Independent Director as the Board’s Chairman (CHSINED) in 2003 and Firm Performance 2003 and 2004
(The Testing of HBL 2)

CHSINED = Board’s chairman is senior independent director, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMD1 = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies’, Public Listed Companies’/Corporations’ and Other Institutions’ substantial equity holdings, PROP = Property industry, CONSTR= Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable’s acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All F² statistical values were significant at the 0.05 level]

Performance Measure	NTOBIN’S Q 2003		NROE 2003		NTOBIN’S Q 2004		NROE 2004	
Adj R ²	0.2645		0.1867		0.0579		0.1108	
R ²	0.3213		0.2495		0.1324		0.1811	
F	5.6543		3.9700		1.7775		2.5763	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1110	-0.7174	0.0776	0.4767	0.0694	0.3920	-0.0507	-0.2947
<i>Explanatory Variables (β)</i>								
CHSINED03	0.1518	0.3409	0.2591	0.5533	-0.1365	-0.2678	-0.1832	-0.3703
<i>Control Variables</i>								
NASET03	-0.3464	-3.8882***	0.4216	4.4991***			0.2050	2.0710**
NDEQ03	0.3422	5.0417***					0.1588	2.1060**
NINED03	0.1446	2.2470**	-0.1689	-2.4950**				
NFORS3	0.1982	2.2042**						
NINSTL03	0.2680	2.6824***					0.2122	1.9112*
<i>Industry Dummy</i>								
PROP	-0.6867	-3.1630***			-0.5211	-2.0971**	-0.4098	-1.6989*
CONSTR							-0.4976	-1.8492
FIN					-0.4937	-1.7376*		

III) Founder as Board's Chairman (CHFOUND) and Firm Performance – OLS 2(iii)

Tables 7.15 and 7.16 respectively present the regression results derived from the research model OLS 2(iii)(a) [i.e. regression analysis of CHFOUND and specified board leadership independent variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 2(iii)(b) [i.e. regression of CHFOUND and specified board leadership variables in 2003 with respective firm performance 2003 and 2004]. Specifically, OLS 2(iii) investigated the impact of the appointment of founder as board's chairman (CHFOUND: HBL 3) on firm performance.

HBL 3 (see Chapter 5 section 5.1.2) hypothesised that the appointment of the founder as the board's chairman (CHFOUND) will have an impact on firm performance. Specifically, the OLS 2(iii)(a) results revealed a significant positive relationship between CHFOUND in 2002 and NROE in 2002 ($\beta = 0.52$; $p = 0.05$) and NROE in 2003 ($\beta = 0.47$; $p = 0.05$).

With respect to hypothesis HBL 6, it was hypothesised in Chapter 5 section 5.1.2 that the separate appointment of CEO and board's chairman (SEPCEO) will have a positive impact on firm performance. OLS 2(iii)(a) results revealed when the founder of the firm was the board's chairman, there existed significant positive relationship between SEPCEO in 2002 and NROE in 2003 ($\beta = 0.46$; $p = 0.05$).

Table 7. 15: Board Leadership and Firm Performance -- OLS 2(iii)(a)
The Appointment of Founder as Board's Chairman (CHFOUND) in 2002 and Firm Performance 2002 and 2003
(The Testing of HBL 3)

CHFOUND = Board's chairman is founder, SEPCEO = Separate appointment of board's chairman and CEO, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR = Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All F statistical values were significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2336		0.1658		0.2194		0.1608	
R ²	0.2963		0.2341		0.2832		0.2295	
F	4.7258		3.4296		4.4344		3.3423	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1738	-0.7153	-0.3014	-1.1893	-0.2182	-0.8899	-0.4925	-1.9375*
<i>Explanatory Variables (β)</i>								
CHFOUND02	0.2424	1.1147	0.5218	2.3005**	0.0696	0.3172	0.4729	2.0785**
SEPCEO02	0.0783	0.3952	0.1972	0.9539	0.0372	0.1860	0.4604	2.2208**
<i>Control Variables</i>								
NASET02	-0.2952	-3.2634***	0.3688	3.9080***	-0.2607	-2.8552***	0.3298	3.4842***
NDEQ02	0.2067	2.9734***			0.3414	4.8654***		
NFAMDI02	-0.1850	-2.3290**						
NFORS2	0.1968	2.1093**			0.1806	1.9181*		
NINSTL02			0.1737	1.6588*	0.1828	1.8050*		
<i>Industry Dummy</i>								
PROP	-0.8942	-3.9787***			-0.7567	-3.3357***		
CONSTR	0.4141	1.6614*			0.5030	1.9992**		
FIN					-0.4816	-1.8522*		

**Table 7. 16: Board Leadership and Firm Performance – OLS 2(iii)(b)
The Appointment of a Senior Independent Director as the Board’s Chairman (CHSINED) in 2003 and Firm Performance 2003 and 2004
(The Testing of HBL 3)**

CHFOUND = Board’s chairman is founder, SEPCEO = Separate appointment of board’s chairman and CEO, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMD1 = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies’, Public Listed Companies’/Corporations’ and Other Institutions’ substantial equity holdings, PROP = Property industry, CONSTR= Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable’s acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All t-statistical values were significant at the 0.05 level]

Performance Measure	NTOBIN’S Q 2003		NROE 2003		NTOBIN’S Q 2004		NROE 2004	
Adj R ²	0.2621		0.1846		0.0564		0.1181	
R ²	0.3225		0.2513		0.1354		0.1919	
F	5.3416		3.7662		1.7142		2.5996	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0036	-0.0143	-0.0585	-0.2225	0.2487	0.8690	-0.3847	-1.3915
<i>Explanatory Variables (β)</i>								
CHFOUND03	0.0377	0.1842	0.1676	0.7786	0.0167	0.0714	0.2495	1.1030
SEPCEO03	-0.1321	-0.6290	0.1075	0.4869	-0.2061	-0.8580	0.3113	1.3420
<i>Control Variables</i>								
NASET03	-0.3496	-3.9024***	0.4157	4.4141***			0.1992	2.0129**
NDEQ03	0.3396	4.9934***					0.1674	2.2283**
NINED03	0.1445	2.2343**	-0.1600	-2.3533**				
NFORS3	0.1925	2.1403**						
NINSTL03	0.2774	2.7321***						
<i>Industry Dummy</i>								
PROP	-0.6838	-3.1291***			-0.5171	-2.0695**		
CONSTR							-0.4932	-1.8188*
FIN					-0.4922	-1.7267*		

IV) Non-Executive Director as Board's Chairman (CHNED) and Firm Performance - OLS 2(iv)

Table 7.17 and 7.18 respectively present the regression results derived from the research model OLS 2(iv)(a) [i.e. regression analysis of CHNED and specified board leadership independent variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 2(iv)(b) [i.e. regression of CHNED and specified board leadership variables in 2003 with respective firm performance 2003 and 2004]. Specifically, OLS 2(iv) investigated the impact of the appointment of a non executive director as the board's chairman (CHNED: HBL 4) on firm performance.

Hypothesis HBL 4 (see Chapter 5, section 5.1.2) proposed that, the appointment of a non-executive director as the board's chairman will have an impact on firm performance. OLS 2(iv)(a) results (see Table 7.17) pointed to a significant positive relationship between CHNED in 2002 and NROE in 2003 ($\beta = 0.27$; $p = 0.1$).

Table 7. 17: Board Leadership and Firm Performance – OLS 2(iv)(a)
The Appointment of a Non-Executive Director as the Board’s Chairman (CHNED) in 2002 and Firm Performance 2002 and 2003
(The Testing of HBL 4)

CHNED = Board’s chairman is non-executive director, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies’, Public Listed Companies’/Corporations’ and Other Institutions’ substantial equity holdings, PROP = Property industry, CONSTR = Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable’s acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All F statistical values were significant at the 0.001 level]

Performance Measure	NTOBIN’S Q 2002		NROE 2002		NTOBIN’S Q 2003		NROE 2003	
Adj R ²	0.2327		0.1539		0.2228		0.1498	
R ²	0.2919		0.2193		0.2829		0.2155	
F	4.9237		3.3534		4.7105		3.2807	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0465	-0.2783	-0.0779	-0.4441	-0.1770	-1.0532	-0.1045	-0.5948
<i>Explanatory Variables (β)</i>								
CHNED02	-0.0039	-0.0286	0.1749	1.2295	0.0174	0.1278	0.2739	1.9207*
<i>Control Variables</i>								
NASET02	-0.2904	-3.2127***	0.3818	4.0227***	-0.2592	-2.8490***	0.3399	3.5730***
NDEQ02	0.2003	2.8950***			0.3399	4.8804***		
NFAMDI02	-0.1734	-2.1970**						
NFORS2	0.2097	2.2444**			0.1858	1.9764**		
NINSTL02					0.1811	1.7719*		
<i>Industry Dummy</i>								
PROP	-0.8832	-3.9269***			-0.7519	-3.3217***		
CONSTR	0.4400	1.7719*			0.5149	2.0603**		
FIN					-0.4906	-1.9007*		

Table 7. 18: Board Leadership and Firm Performance -- OLS 2(iv)(b)
The Appointment of a Non-Executive Director as the Board's Chairman (CHNED) in 2003 and Firm Performance 2003 and 2004
(The Testing of HBL 4)

CHNED = Board's chairman is non-executive director, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR = Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All t-statistical values were significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2665		0.1884		0.0647		0.1105	
R ²	0.3232		0.2511		0.1386		0.1809	
F	5.7015		4.0038		1.8743		2.5715	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1427	-0.8968	0.0419	0.2504	0.0167	0.0921	-0.0610	-0.3444
<i>Explanatory Variables (β)</i>								
CHNED03	0.1100	0.8133	0.1221	0.8587	0.1891	1.2247	0.0397	0.2636
<i>Control Variables</i>								
NASET03	-0.3402	-3.8074***	0.4283	4.5572***			0.2078	2.0905**
NDEQ03	0.3423	5.0550***					0.1607	2.1324**
NINED03	0.1558	2.3884**	-0.1556	-2.2671**				
NFORS3	0.2011	2.2436**						
NINSTL03	0.2448	2.3587*					0.2039	1.7657*
<i>Industry Dummy</i>								
PROP	-0.6939	-3.1995***			-0.5292	-2.1370**	-0.4099	-1.6985*
CONSTR							-0.4924	-1.8317*
FIN					-0.5166	-1.8225*		

V) **Family-Member Director as Board's Chairman (CHFAM) and Firm Performance - OLS 2(v)**

Tables 7.19 and 7.20 respectively present the regression results derived from the research model OLS 2(v)(a) [i.e. regression analysis of CHFAM and specified board leadership independent variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 2(v)(b) [i.e. regression of CHFAM and specified board leadership variables in 2003 with respective firm performance 2003 and 2004]. Specifically, OLS 2(v) investigated the impact of the appointment of a family-member director as the board's chairman (CHFAM: HBL 5) on firm performance.

Hypothesis HBL 5 postulated that the appointment of a family-member director as the board's chairman will have an impact on firm performance. OLS 2(v)(a) and (b) results pointed to the contrary. The relationship between CHFAM and firm performance was not statistically significant, both in terms of market value (NTobin's Q) and accounting-based measures (NROE) of firm performance.

On the other hand, when the family director was appointed as the board's chairman, there existed a significant positive relationship between the separate appointment of CEO and board chairman (SEPCEO) in 2002 and NROE in 2003 ($\beta = 0.43$; $p = 0.05$).

Table 7. 19: Board Leadership and Firm Performance – OLS 2(v)(a)
The Appointment of a Family-Member Director as the Board's Chairman (CHFAM) in 2002 and Firm Performance 2002 and 2003
(The Testing of HBL 5)

CHFAM = Board's chairman is family-member director, SEPCEO = Separate appointment of board's chairman and CEO, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies /Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR= Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (), 0.05(**), 0.01(***); All F statistical values were significant at the 0.001 level]*

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2307		0.1496		0.2217		0.1489	
R ²	0.2937		0.2192		0.2854		0.2186	
F	4.6660		3.1504		4.4818		3.1391	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1439	-0.5763	-0.2065	-0.7865	-0.2819	-1.1224	-0.4242	-1.6149
<i>Explanatory Variables (β)</i>								
CHFAM02	0.1111	0.6935	0.1950	1.1582	0.1360	0.8441	0.2022	1.2004
SEPCEO02	0.0670	0.3308	0.1552	0.7292	0.0754	0.3705	0.4326	2.0314**
<i>Control Variables</i>								
NASET02	-0.2931	-3.2349***	0.3744	3.9302***	-0.2630	-2.8852***	0.3342	3.5063***
NDEQ02	0.1963	2.8220***			0.3351	4.7879***		
NFAMDI02	-0.2048	-2.2357**						
NFORS2	0.1996	2.1213**			0.1705	1.8017*		
NINSTL02					0.1833	1.8125*		
<i>Industry Dummy</i>								
PROP	-0.8850	-3.9339***			-0.7557	-3.3397***		
CONSTR	0.4364	1.7538*			0.5080	2.0295**		
FIN					-0.4966	-1.9156*		

Table 7. 20: Board Leadership and Firm Performance – OLS 2(v)(b)
The Appointment of a Family-Member Director as the Board's Chairman (CHFAM) in 2003 and Firm Performance 2003 and 2004
(The Testing of HBL 5)

CHFAM = Board's chairman is family-member director, SEPCEO = Separate appointment of board's chairman and CEO, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMD1 = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR = Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (), 0.05 (**), 0.01 (***) ; All V statistical values were significant at the 0.05 level]*

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2634		0.1821		0.0607		0.1128	
R ²	0.3236		0.2491		0.1393		0.1871	
F	5.3697		3.7220		1.7714		2.5193	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0527	-0.2017	0.0043	0.0156	0.1466	0.4918	-0.2825	-0.9756
<i>Explanatory Variables (β)</i>								
CHFAM03	0.0983	0.6142	-0.0150	-0.0892	0.1728	0.9455	-0.0364	-0.2053
SEPCEO03	-0.1119	-0.5265	0.0882	0.3941	-0.1659	-0.6836	0.2793	1.1852
<i>Control Variables</i>								
NASET03	-0.3545	-3.9486***	0.4229	4.4706***			0.2108	2.1172**
NDEQ03	0.3377	4.9705***					0.1648	2.1871**
NINED03	0.1481	2.2850**	-0.1653	-2.4202**				
NFORS3	0.1878	2.0885**						
NINSTL03	0.2741	2.6995***					0.1918	1.7033*
<i>Industry Dummy</i>								
PROP	-0.6752	-3.0945***			-0.4967	-1.9936**	-0.4135	-1.7090*
CONSTR	0.4154	1.6736*					-0.5397	-1.9609*
FIN					-0.4989	-1.7612*		

VI) The Separate Appointment of CEO and Board's Chairman (SEPCEO) and Firm Performance – OLS 2(vi)

Table 7.21 and 7.22 respectively present the regression results obtained from the research model OLS 2(vi)(a) [i.e. regression analysis of SEPCEO and specified board leadership independent variables in 2002 with respective firm performance 2002 and 2003] and the research model OLS 2(vi)(b) [i.e. regression of SEPCEO and specified board leadership variables in 2003 with respective firm performance 2003 and 2004]. Specifically, OLS 2(vi) investigated the impact of the separate appointment of CEO and board chairman (SEPCEO) on firm performance.

Hypothesis HBL 6 proposed that the separate appointment of CEO and board chairman (SEPCEO) will have a positive impact on firm performance. OLS 2(vi)(a) results indicated a positive relationship between SEPCEO in 2002 and NROE in 2003 ($\beta = 0.35$; $p = 0.1$).

Table 7. 21: Board Leadership and Firm Performance -- OLS 2(vi)(a)
The Separate Appointment of CEO and Board Chairman (SEPCEO) in 2002 and Firm Performance 2002 and 2003
(The Testing of HBL 6)

SEPCEO = Separate appointment of board's chairman and CEO, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, NFAF= Proportion of family-member directors with accounting and finance background, PROP = Property industry, CONSTR= Construction industry, FIN = Finance industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05(**), 0.01(***); All t statistical values were significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2327		0.1482		0.2228		0.1471	
R ²	0.2920		0.2140		0.2829		0.2130	
F	4.9248		3.2513		4.7102		3.2320	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0667	-0.2989	-0.0710	-0.3016	-0.1874	-0.8342	-0.2837	-1.2051
<i>Explanatory Variables (β)</i>								
SEPCEO02	0.0227	0.1183	0.0774	0.3830	0.0212	0.1099	0.3519	1.7398*
<i>Control Variables</i>								
NASET02	-0.2900	-3.2087***	0.3799	3.9888***	-0.2592	-2.8491***	0.3398	3.5659***
NDEQ02	0.1999	2.8849***			0.3394	4.8671***		
NFAMDI02	-0.1723	-2.1912**						
NFORS2	0.2112	2.2846**			0.1847	1.9856**		
NINSTL02					0.1825	1.8061*		
<i>Industry Dummy</i>								
PROP	-0.8832	-3.9310***			-0.7535	-3.3324***		
CONSTR	0.4379	1.7622*						
FIN					-0.4872	-1.8826*		

Table 7. 22: Board Leadership and Firm Performance – OLS 2(vi)(b)
The Separate Appointment of CEO and Board Chairman (SEPCEO) in 2003 and Firm Performance 2003 and 2004
(The Testing of HBL 6)

SEPCEO = Separate appointment of board's chairman and CEO, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMD1 = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINDPV = Total Proportion of Individuals' and/or Private Companies' substantial equity holdings, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, NFAF= Proportion of family-member directors with accounting and finance background, PROP = Property industry, CONSTR= Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All statistical values were significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2656		0.1861		0.0612		0.1171	
R ²	0.3224		0.2490		0.1354		0.1869	
F	5.6808		3.9598		1.8239		2.6780	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.0085	0.0351	-0.0051	-0.0199	0.2540	0.9218	-0.3051	-1.1426
<i>Explanatory Variables (β)</i>								
SEPCEO03	-0.1356	-0.6500	0.0919	0.4183	-0.2076	-0.8703	0.2881	1.2462
<i>Control Variables</i>								
NASET03	-0.3482	-3.9101***	0.4219	4.5004***			0.1643	2.1867**
NDEQ03	0.3392	5.0020***						
NINED03	0.1435	2.2320**	-0.1646	-2.4323**				
NFORS3	0.1915	2.1379**						
NINDPV03							0.1902	1.6972*
NINSTL03	0.2784	2.7528***						
<i>Industry Dummy</i>								
PROP	-0.6879	-3.1714			-0.5189	-2.0926**	-0.4088	-1.7013*
CONSTR							-0.5287	-1.9629*
FIN					-0.4941	-1.7452*		

Table 7.23 below summarises findings for the impact of board leadership on firm performance.

Table 7.23: Summary of Findings for the Impact of Board Leadership Impact on Firm Performance

<i>Board Leadership and Firm Performance ---OLS 2</i>		
Hypothesis	Postulated Relationship	Results
HBL 1: <i>Appointment of INED Board's Chairman [CHINED]</i>	+	Supported
HBL 2: <i>Appointment of SRINED Board's Chairman [CHSINED]</i>	+	Not Supported
HBL 3: <i>Appointment of FOUN Board's Chairman [CHFOUND]</i>	?	Positive Relationship
HBL 4: <i>Appointment of NED Board's Chairman [CHNED]</i>	?	Positive Relationship
HBL 5: <i>Appointment of FAMD Board's Chairman [CHFAM]</i>	?	?
HBL 6: <i>Separate Appointment of CEO and Board's Chairman [SEPCEO]</i>	+	Supported

7.2.2.1 Discussions of the Impact of Board Leadership on Firm Performance --- OLS 2(i), OLS 2(ii), OLS 2(iii), OLS 2(iv) and OLS (v) Results

(I) Independent Director (CHINED) and Senior Independent Director (CHSINED) as the Board's Chairman

OLS 2(i)(b) result (see Table 7.12) showed that the chairing of the board of directors by independent director (CHINED) had a significant positive impact on firm performance. Namely, the finding supported Useem (1998) and Gregory (2001) propositions that independent board chairman is significant to establish impartiality, integrity and credibility in board judgements and conducts.

On the other hand, OLS 2(ii)(a) and (b) results (see Tables 7.13 and 7.14) showed no significant relationship between the chairing of a board of directors by senior independent director (CHSINED) and firm performance. Fama and Jensen, 1983(a); Anderson and Anthony, 1986; Daily and Dalton, 1993 contended, it is imperative for board chairman to spend constructive time

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in overseeing, directing and managing board members activities to ensure board efficiency and credibility in making firm decisions. Given that senior independent directors hold several directorships in other companies, his/her effectiveness as board's chairman may have been affected by his/her abilities to allocate appropriate and sufficient time in monitoring organisational process (Eisenhardt and Schoonhoven, 1990), setting relevant board agendas (Dayton, 1984) and disciplining management activities (Kose and Senbet, 1998).

Furthermore, according to Lee (1977), the influence and ability of a leader to initiate and undertake strategic changes in the organisation have an impact on firm management and potentially its performance. In particular, changes in the firm's management will be carried out effectively when subordinates are confident of the superiority of the leader's management plan (see Daily and Johnson, 1993). Vecchio (2003) also argued that the entrepreneurial skill of the firm's leader has implications for his/her ability to identify business opportunities as well as propose profitable business plans. In addition, the motivation and commitment of the leader to achieve higher firm performance level further influences his/her effectiveness in managing the firm's strategic direction (Begly and Boyd, 1987). Shamir et al., (1998) posited that charismatic quality is an important attribute of a leader, especially for encouraging cooperation amongst group members for the attainment of organisational tasks and goals.

Accordingly, senior independent directors need to enhance their leadership skills, pursue their leadership duty with full commitment, ensure their understanding of the business operation, and take the initiative to obtain relevant information required for better management of the firm's board and hence performance. Hall (1992) further indicated that the reputation of the members

of a group, namely, their managerial abilities and experience, have implications for group strategic decision-making.

Lipton and Lorsch (1992:62) noted Chancellor Allen⁷² views that the inability of board members, in this case, the independent chairman, to provide sufficient advice to the firm's CEO during a crisis period, namely, emergency succession planning or threatened insolvency, may indicate director deficiency. Potentially, the attributes of the independent or senior independent director as board chairman on their own may not be sufficient to enhance the firm's value when other board members do not possess the same qualities as him/her. In addition the CEO's control of the quality and quantity of information supplied by management to the independent board's chairman may also affect the chairman's ability to make informed economic decision (Dalton et al., 1998).

II) Founder as Board's Chairman (CHFOUND)

On the other hand the chairing of the board by a founder (**CHFOUND**) had a significant positive impact on firm performance (see Tables 7.15 and 7.16). This finding was consistent with that reported by Villalonga and Amit (2006), who found a positive impact on firm value when the board of directors was chaired by the founder and the firm's CEO was not a family member. Founder leadership facilitates monitoring of non owner-manager actions, whilst, the appointment of a non-family member as CEO enhances the professionalism of the firm's management. Specifically, the reliability of founder leadership will be established when there is no control enhancing mechanism that facilitates expropriation of non-family shareholders'

⁷² Chancellor, William T. Allen, Delaware Court of Chancery, Redefining the Role of Outside Directors in An Age of Global Competition, presented at the Ray Garrett Jr., Corporate and Securities Law Institute, North Western University, Chicago (Apr. 1992).

interests, such as differential voting right and/or multiple share classes (see McConaughy et al., 1998; Ho et al., 2004; Villalonga and Amit, 2006: 388).

III) Non-Executive Director as Board's Chairman (CHNED)

In terms of the impact of non-executive director chairman (CHNED) on firm performance, section 7.2.2 (IV) [see Table 7.17], a significant positive relationship ($p = 0.1$) was noted between the two variables. Non-executive directors include affiliated directors, nominee directors (i.e. representatives of institutional investors, government or corporations) and family member directors not holding a position in the firm's management. The non-executive director's equity interest in the firm or business association with the firm provides him/her better with understanding of the firm's business operations, ease of communication with the firm's management and personnel, and executives' co-operation (see Finkelstein, 1992). In particular, Lipton and Lorsch (1992) noted that the appointment of an institutional investor representative on the firm's board ensures better communication and close monitoring of their investments. These factors may have contributed to the effectiveness of the non-executive chairman's leadership of the firm's board and hence better firm performance.

IV) Family-Member Director as Board's Chairman (CHFAM)

In section 7.2.2 (V), the insignificant impact of family-director chairman (CHFAM) on firm performance was identified. Potentially, the family-member chairman's contribution to firm performance may not be carried out in line with maximisation of shareholders' interests. According to Boeker (1992), family-member directors have the tendency to blame other managers for poor performance. Given their large ownership of shares in the firm, some family

members will insist on their term of office being extended even though they are performing badly (Allen and Panian, 1982). Further, Allen and Panian argued that, family member presence in the board increases their domination of the internal political process. The appointment of a family-member director as the board's chairman may not be undertaken due to his/her leadership quality but may be driven by the need of family-members to strengthen their control of the firm's management (see McConaughy et al., and Morck and Yeung, 2003).

(V) The Separate Appointment of CEO and Board's Chairman (SEPCEO)

The current study also found that separation of the appointment of board chairman and CEO (SEPCEO) has a significant positive ($p = 0.1$; $p = 0.05$) impact on firm value (see Tables 7.21 and 7.22). This finding supports Fama and Jensen's [1983(a)] argument that the firm performance will be affected when the role of the board's chairman and CEO is combined. Notably, they found that the firm will suffer in the competition for survival when the firm's decision management and control are dominated by one person. In particular, the separation of board chairman and CEO roles signifies orderly management of organisational activities and facilitates a healthy relationship amongst board members (Anderson and Anthony, 1986).

(VI) Control Variable - The appointment of specific foreign directors (NFORS)

Furthermore, the appointment of specific foreign directors (NFORS) on the firm's board, namely from countries with strong corporate governance system such as United States of America, European countries (i.e. United Kingdom, France, Germany, Denmark, Switzerland), Australia and Singapore revealed a significant positive relationship ($p = 0.05$) with market value measure of firm performance (Tobin's Q) [see Tables 7.11 to 7.16]. The result supported

Øxelheim and Randøy (2003) arguments that firms' inclusion of foreign directors on their board of directors signified their willingness and commitment to enhance the transparency, integrity and credibility of the monitoring practices of their business activities. Given their knowledge and experience of corporate governance system of their countries, the foreign directors would likely employ the same vigilant procedures when evaluating management investment propositions (see Ramaswamy and Li, 2001).

7.2.3 Board of Director's Competency and Firm Performance – OLS 3

As discussed in Chapter 5, section 5.1.3, the impact of board of directors' competency on firm performance was examined by the research model OLS 3. Specifically, OLS 3 represented the model of the relationship between the proportion of board members with certain higher education levels (NDEG, NMASK, NPHD and NPROFL: HBKNOW 1) and acquirement of specified knowledge and skills (NACTGK, NFINK, NBUSK, NLAWK, NEXEPROG and NCHASEC: HBKNOW 2) respectively, and firm performance. Specifically, OLS 3(i) examined the impact of the proportion of directors with a degree (NDEG), Master degree (NMASK), doctorate (NPHD) and professional qualification (NPROFL) on firm performance. While, OLS 3(ii) evaluated the impact of board of directors' area of expertise, namely the proportion of directors with accounting (NACTGK), finance (NFINK), business (NBUSK), law (NLAWK) expertise, attending the executive management programme course (NEXEPROG) and company secretary experience (NCHASEC) on firm performance. The following subsections analyse the results derived from OLS 3(i) and OLS 3(ii) respectively.

d) Board of Directors' Educational Level and Firm Performance – OLS 3(i)

Tables 7.24 and 7.25 present the regression results derived from the OLS 3(i)(a) [i.e. regression of specified board educational level variables in 2002 with respective firm performance 2002 and 2003] and the OLS 1(i)(b) model [i.e. regression of specified board educational level in 2003 with respective firm performance 2003 and 2004].

In Chapter 5, section 5.1.3, hypothesis HBKNOW 1 proposed that the proportion of board of director members with a particular level of higher education will have an impact on firm performance [NDEG, NMASK, NPROFL and NPHD]. With respect to the impact of proportion of board members with Bachelor degree (NDEG) on firm performance, the OLS 3(i)(b) result revealed a significant negative relationship between NDEG in 2003 and NROE in 2004 ($\beta = -0.17$; $p = 0.1$). In terms of board members with a Masters degree, OLS 3 (i)(a) and OLS 3(i)(b) results [see Tables 7.24 and 7.25] pointed to a significant negative relationship between the proportion of board members with a Masters degree (NMASK) in 2002 and NROE in 2002 ($\beta = -0.18$; $p = 0.05$) and NROE in 2003 ($\beta = -0.21$; $p = 0.05$), and between NMASK in 2003 and NROE in 2003 ($\beta = -0.19$; $p = 0.05$) and NROE in 2004 ($\beta = -0.18$; $p = 0.05$).

Further, there existed a significant positive relationship between board members with a professional qualification (NPROFL) in 2002 and NROE in 2002 ($\beta = 0.22$; $p = 0.01$). On the other hand, the relationship between board members with a Doctor of Philosophy qualification (NPHD) and firm performance revealed mixed significant results. Namely, when NPHD in 2002 was measured with respective NTobin's Q and NROE in 2002 r, the results showed a significant positive ($\beta = 0.16$; $p = 0.1$) and negative ($\beta = -0.16$; $p = 0.1$) relationship.

Table 7. 24: Board Competency and Firm Performance -- OLS 3(i)(a)
The Examination of Board of Directors' Educational Level in 2002 and Firm Performance in 2002 and 2003
(The Testing of HBKNOW 1)

NDEG = Proportion of directors with Bachelor degree, NMASK = Proportion of directors with masters degree, NPROFL = Proportion of directors with professional qualification, NPHD = Proportion of directors with Doctor of Philosophy, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05(**), 0.01(***); All F statistical values were significant at 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
<i>Adj R²</i>	0.2374		0.1987		0.2114		0.1558	
<i>R²</i>	0.3102		0.2752		0.2867		0.2364	
<i>F</i>	4.2618		3.5982		3.8085		2.9334	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.2038	-1.0254	0.0350	0.1721	-0.2667	-1.3216	-0.0529	-0.2535
<i>Explanatory Variables (β)</i>								
NDEG02	0.0635	0.7219	0.0163	0.1868	-0.0118	-0.1368	0.0462	0.5165
NMASK02	-0.0131	-0.1545	-0.1799	-2.1668**	-0.0092	-0.1115	-0.2092	-2.4542**
NPROFL02	-0.0207	-0.2754	0.2224	2.9956***	0.0330	0.4477	0.1043	1.3688
NPHD02	0.1568	1.6759*	-0.1599	-1.6627*	0.0419	0.4386	0.0971	0.9839
<i>Control Variables</i>								
NASET02	-0.3229	-3.4608***	0.3958	4.1465***	-0.2779	-2.9343***	0.3237	3.3030
NDEQ02	0.1987	2.8415***			0.3397	4.7837***		
NFAMDI02	-0.2007	-2.3804**						
NFORS02	0.2075	2.2131**	-0.1864	-1.9395*	0.1690	1.7725*		
NINSTL02			0.2470	2.3435**	0.1780	1.7027*		
<i>Industry Dummy</i>								
PROP	-0.9410	-4.0958***			-0.7319	-3.1451***		
CONSTR	0.4631	1.8487*			0.5306	2.0663**		
FIN					-0.4815	-1.8010*		

Table 7. 25: Board Competency and Firm Performance -- OLS 3(i)(b)
The Examination of Board of Directors' Educational Level in 2003 and Firm Performance in 2003 and 2004
(The Testing of HBKNOW 1)

NDEG = Proportion of directors with Bachelor degree, NMASK = Proportion of directors with masters degree, NPROFL = Proportion of directors with professional qualification, NPHD = Proportion of directors with Doctor of Philosophy, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Directors, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: V for the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); V for the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All V statistical values were significant at 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2688		0.1986		0.0735		0.1270	
R ²	0.3386		0.2751		0.1640		0.2123	
F	4.8522		3.5957		1.8124		2.4895	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.2733	-1.3988	0.0687	0.3359	-0.2223	-0.9993	-0.0404	-0.1871
<i>Explanatory Variables (β)</i>								
NDEG03	-0.0911	-1.1166	-0.0002	-0.0019	-0.1655	-1.7822*	0.0532	0.5902
NMASK03	-0.0289	-0.3747	-0.1942	-2.4073**	0.0228	0.2605	-0.1830	-2.1513**
NPROFL03	0.0833	1.1517	0.0514	0.6787	0.0062	0.0751	0.1048	1.3116
NPHD03	-0.0092	-0.0953	0.0153	0.1510	0.0850	0.7711	-0.0328	-0.3065
<i>Control Variables</i>								
NASET03	-0.3669	-4.0136***	0.4263	4.4544***	-0.1745	-1.6770*	0.2015	1.9966**
NDEQ03	0.3392	4.9166***					0.1370	1.7988*
NINED03	0.1438	2.2439**	-0.1663	-2.4782**				
NFORS03	0.1857	2.0644**						
NINDPV03							0.1790	1.7866*
NINSTL03	0.2725	2.6608***					0.2557	2.2614**
AUF503					0.3128	1.9811**		
<i>Industry Dummy</i>								
PROP	-0.6600	-3.0038***			-0.4391	-1.7557*	-0.4415	-1.8196*
CONSTR	0.4073	1.6577*					-0.5707	-2.1039**
FIN			-0.4838	-1.8310*				

II) Board of Directors' Areas of Expertise and Firm Performance - OLS 3(ii)

Tables 7.26 and Table 7.27 present the regression results derived from the OLS 3(ii)(a) [i.e. regression of specified board's members areas of expertise in 2002 with respective firm performance 2002 and 2003] and OLS 3(ii)(b) [i.e. regression of specified board members' areas of expertise in 2003 with respective firm performance 2003 and 2004].

In Chapter 5, section 5.1.3, HBKNOW 2 hypothesised that the proportion of directors with an accounting, finance, business and/management, law, that had attended executive management programme and company secretary qualification will have an impact on firm performance [NACTGK, NFINK, NBUSK, NLAWK, NEXEP and NCHASEC]. With respect to the impact of proportion of board members with finance qualification (NFINK), the OLS 3(ii)(b) results revealed a significant positive relationship between NFINK in 2003 and NTobin's Q in 2003 ($\beta = 0.17$; $p = 0.05$), and NROE in 2003 ($\beta = 0.14$; $p = 0.1$) respectively.

In addition, OLS 3(ii)(a) results pointed to a significant negative relationship between the proportion of board members with a business qualification (NBUSK) in 2002 and Tobin's Q in 2002 ($\beta = -0.19$; $p = 0.01$), and NROE in 2002 ($\beta = -0.13$; $p = 0.1$), and NTobin's Q in 2003 ($\beta = -0.14$; $p = 0.1$) respectively. In terms of the relationship between proportion of board members with a law qualification (NLAWK) and firm performance, OLS 3(ii)(a) result revealed a significant positive relationship between NLAWK in 2002 and NROE in 2002 ($\beta = 0.18$; $p = 0.05$). Furthermore, there existed a significant positive relationship between proportion of board members that had attended an executive management programme (NEXEP) in 2002 and NROE in 2002 ($\beta = 0.17$; $p = 0.1$) [See OLS 3(i)(a)].

Table 7. 26: Board Competency and Firm Performance -- OLS 3(ii)(a)
The Examination of Board of Director Members' Areas of Expertise in 2002 and Firm Performance in 2002 and 2003
(The Testing of HBKNOW 2)

NACTGK = Proportion of directors with formal accounting education, NFINK = Proportion of directors with formal finance education, NBUSK = Proportion of directors with formal business/management education, NLAWK = Proportion of directors with formal law education, NEXEP = Proportion of directors who attended executive management programme, NCHASEC = Proportion of directors with company secretary experience, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Director, AUF5 = Firm's external auditor is one of the Big 5 audit firms, MAINB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All statistical values are significant at 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2359		0.1536		0.2060		0.1302	
R ²	0.3019		0.2267		0.2746		0.2054	
F	4.5740		3.1008		4.0039		2.7340	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.2792	-1.4255	-0.0767	-0.3719	-0.3456	-1.7311*	-0.1194	-0.5713
<i>Explanatory Variables (β)</i>								
NACTGK02	-0.0545	-0.8309	0.0791	1.1456	0.0038	0.0572	-0.0345	-0.4929
NFINK02	0.0366	0.4560	0.0143	0.1693	0.0218	0.2659	-0.0069	-0.0810
NBUSK02	-0.1924	-2.8444***	-0.1280	-1.7980*	-0.1358	-1.9692*	-0.0934	-1.2947
NLAWK02	-0.0760	-1.0159	0.1753	2.2254**	0.0549	0.7197	-0.0512	-0.6413
NEXEP02	0.0741	0.7445	0.0436	0.4164	0.1693	1.6694*	-0.0529	-0.4979
NCHASEC02	0.1184	1.0420	0.1115	0.9324	-0.0050	-0.0432	0.1187	0.9794
<i>Control Variables</i>								
NASET02	-0.2719	-3.0346***	0.4000	4.2419***	-0.2546	-2.7877***	0.3525	3.6873***
NDEQ02	0.1889	2.7093***			0.3411	4.7994***		
NFAMDI02	-0.2504	-3.3250***						
AUF02	0.2622	1.8762*						
<i>Industry Dummy</i>								
MAINB					0.3233	1.8210*		
PROP	-1.0123	-4.4605***			-0.8711	-3.7653***		
CONSTR					0.4124	1.6529*		
FIN					-0.5353	-1.9694*		

Table 7. 27: Board Competency and Firm Performance -- OLS 3(ii)(b)
The Examination of Board of Director's Members Areas of Expertise in 2003 and Firm Performance in 2003 and 2004
(The Testing of HBKNOW 2)

NACTGK = Proportion of directors with formal accounting education, NFINK = Proportion of directors with formal finance education, NBUSK = Proportion of directors with formal business/management education, NLAWK = Proportion of directors with formal law education, NEXEP = Proportion of directors who attended executive management programme, NCHASEC = Proportion of directors with company secretary experience, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of Family-Member Director, AUF5 = Firm's external auditor is one of the Big 5 audit firms, BDSZ = Size of Board of Director, PROP = Properties industry, CONSTR = Construction industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05(**), 0.01(***); All F statistical values are significant at 0.1 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2157		0.1707		0.0476		0.1013	
R ²	0.2834		0.2423		0.1318		0.1807	
F	4.1841		3.3838		1.5658		2.2749	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.4177	-2.0773**	0.1458	0.7051	-0.2768	-1.2352	-0.0626	-0.2879
<i>Explanatory Variables (β)</i>								
NACTGK03	-0.0069	-0.1079	-0.0404	-0.6096	-0.0586	-0.8161	-0.0548	-0.7869
NFINK03	0.1713	2.1329**	0.1447	1.7513*	0.0444	0.4962	0.1171	1.3472
NBUSK03	0.0591	0.8800	0.0100	0.1449	-0.0004	-0.0054	-0.0204	-0.2807
NLAWK03	0.0512	0.6857	0.0612	0.7972	-0.0132	-0.1590	0.0629	0.7787
NEXEP03	0.0045	0.0436	-0.0768	-0.7305	-0.0701	-0.6155	-0.0711	-0.6426
NCHASEC03	-0.0172	-0.1451	-0.0946	-0.7754	0.0466	0.3525	-0.0089	-0.0694
<i>Control Variables</i>								
NASET03	-0.2748	-2.9285***	0.4547	4.7126***			0.2371	2.3362**
NDEQ03	0.3170	4.5088***						
NFAMDI03								
AUF503	0.3097	2.1986**			0.3853	2.4548**		
BDSZ03			0.1213	1.6962*				
<i>Industry Dummy</i>								
PROP	-0.7846	-3.4768***	-0.4040	-1.7409*	-0.5153	-2.0490**	-0.4322	-1.7706*
CONSTR							-0.4718	-1.6975*
FIN	-0.5039	-1.9005**	-0.5005	-1.8359*				

Table 7.28 below summarises the findings for the impact of board competency on firm performance.

Table 7.28: Summary of Findings of the Impact of Board Competency on Firm Performance

<i>Board Competency and Firm Performance --- OLS 3</i>		
Hypothesis HBKNOW	Postulated Relationship	Results
HBKNOW' 1: <i>BOD Higher Level of Education</i> --- OLS 3(i)	+	Supported for board of director's with Professional and PhD qualification
HBKNOW' 2: <i>BOD Areas of Expertise</i> --- OLS 3(ii)	+	Supported for board of directors with finance qualification, law qualification and that had attended executive management program

7.2.3.1 Discussions of the Impact of Board Competency on Firm Performance --- OLS 3(i) and OLS 3(ii) Results

(I) Board of Director Educational Level and Firm Performance

As indicated in section 7.2.3 (I), in most of the cases observed, examination of the impact of board of directors' educational level on firm performance did not reveal a significant relationship between the respective variables. Notably, in one observed case, a significant negative relationship was found between the proportion of directors with a Bachelor degree (NDEG) in 2003 and Tobin's Q in 2004 (see Table 7.25). A study by Schroeder et al., (1967) suggested that a person's educational level has an impact on his/her ability to process complex information. In addition, Laing and Weir (1999) viewed a person's investment in education and training as an initiative to gain future productivity benefits and attainment of future income. In particular, the knowledge and skills acquired through the formal educational process are recognisable and established the person's quality of knowledge (Storey et al., 1995). In the case of the current study, directors' educational background appeared not to be sufficient to assist

them effectively when dealing with matters unique to firm's business circumstances. However, the possession of a higher degree is important to enhance a person's job opportunity in the labour market and attainment of better pay (Laing and Weir, 1999). On the other hand, Yermack (2004) argued that in order for newly appointed directors to contribute to organisational performance, they need time to develop their management skills and understanding of the firm's business operation and their industry experience in past employment may not be applicable for their current job.

With respect to family-business companies, they will appoint their family members to the board of directors regardless of their educational level. Even though family-member directors may lack formal education, they have extensive knowledge and experience of the firm's operations and management. The appointment of an outside director with high educational level in family-business firms can be perceived as the firm's strategic investment in human capital.

OLS 3(i)(a) and (b) [see Tables 7.24 and 7.25] indicated a significant negative relationship between the proportion of directors with a Masters degree (**NMASK**) and firm performance. Potentially, directors with high qualifications may hold many directorship positions in several listed and private companies and/or have a permanent job in the public or private sector. MBSB Listing Ruling only limits directors' board membership in listed firm to 15 companies, whereas no limit is imposed on directorship in private companies. Their various external responsibilities may have affected their commitment to allocate adequate time for effective board decision-making (see Loderer and Peyer, 2002).

On the other hand there existed a positive relationship between the proportion of directors with a professional (**NPROFL**) and Doctor of Philosophy qualification (**NPHD**) and firm performance [see Table 7.24]. According to Laing and Weir (1999), the acquirement of a professional qualification will enhance a person's productivity level given his/her higher ability to process complex information. In addition, Dionne and Triki (2005) identified the professional accountant as an important financial expert asset to the firm. In furtherance of this, Storey et al., (1995) found a positive relationship between professional qualification holders and high pay level. In the current study, there were not many academicians on firms' board of directors. Many directors with a Doctor of Philosophy qualification worked in the private sector or public sector rather than academic institutions. Castanias and Helfat (2001) posited that manager type and managerial experience and skills have implications for firm performance. Potentially, directors' industry and management experience fulfils the firm's resource needs for external environment knowledge (see KLSE and PwC, 2002).

(II) Board of Directors Areas of Expertise and Firm Performance

As reported in section 7.2.3 (II), there was no significant relationship between the proportion of board members possessing respective accounting (**NACTG**) and company secretary experience (**NCHASEC**), and firm performance (see Table 7.26 and 7.27). Lang and Weir (1999) noted that holders of a professional accounting qualification have a greater potential to earn a higher income in the labour market. Moreover, in the Higgs Report (2003), the importance of a company secretary's knowledge of business procedures and corporate governance was emphasised. For effective and efficient management of a firm's complex operations, the firm has to delegate various operational and managerial functions to specific groups of people in the

organisation. Given the size of the board of directors and board members' knowledge and skills, on their own, they would not be able to cater for all responsibilities in the firm. Considerably, directors' relevant industry experience may have greater influence on the firm performance (see Taylor, 2001).

Furthermore, OLS 3(ii)(b) result [see Table 7.27] indicated that there existed significant positive relationship between the proportion of board members with finance qualification (**NFINK**) and firm performance. The value of a director with a financial background to the firm, namely, in ensuring access to financial markets has been noted by Lee et al., (1999). Besides that, the financial expert directors' managerial experience in risk management and attitudes towards risk aversion have a potential impact on the board's evaluation of the firm's investment risks and risk policy setting (see Petersen and Thiagarajan, 2000). According to Lee et al., (1999:423); directors with specific finance background such as commercial bankers, executives of insurance companies and investment bankers, will be able to provide the firm with specific information about the financial market condition as well as finance options advice. In addition, their expertise will enhance audit committee member and auditor assessment of the firm's financial circumstances, namely, the firm's business, financial activities and risks (see Booth and Deli, 1999; the Smith Report, 2003: Para 5.4; PwC, 2003; O'Reily et al., 2004).

Accordingly, the relationship between the proportion of directors with higher education in business management (**NBUSK**) related subjects and firm performance was significantly negative (see Table 7.26). When directors' backgrounds were further investigated, it was found that some had several directorships in listed and/or private companies as well as owned their

own business. Directors' various commitments may have affected their performance of duties in the firm, particularly the quality time they were able to allocate for the firm's monitoring (see Li and Ang, 2000).

In addition, a significant positive relationship was also found between the proportion of board members with law qualification (**NLAWK**) and firm performance [see Table 7.26 - OLS 3(ii)(a)]. Notably, the importance of a legal expert advisory service to the board's management has been recognised by Verschoor (1993). Furthermore Elson (1996) revealed, the appointment of lawyer in the firm's board was associated with the company's need for his/her professional service. Moreover, the presence of legal expertise on the board is important to reduce board members exposures to litigation suit due to their unfamiliarity with the law (Borsch and Huse, 1993; Blum and Hoeffner, 2006).

Similarly, there existed a significant positive relationship between proportion of directors attending an executive management programme (**NEXEP**) and firm performance (see Table 7.26). In particular the executive management programme was conducted by top business universities such as Harvard, Wharton, Stanford, INSEAD and the London Business School. Many of the listed companies' board chairman and other board members without a formal education background in finance were enrolled into this financial education programme (see Dionne and Triki, 2005). The executive management programme provided directors with relevant technical and practical expertise for firm's financial management and in consideration of their firm's industry. The financial knowledge acquired from this program enhanced

directors' financial advisory skills and enabled them to act in the best interest of shareholders as a result of their greater comprehension of the financial decisions they had to make.

In terms of the impact of the firm's appointment of big 5 audit firm as its external auditor (**AUF5**) on firm performance, the result of OLS 3(i)(b), 3(ii)(a) and 3(ii)(b) indicated a significant positive relationship between the two respective variables ($p=0.05$ or $p=0.1$). Notably, the presence of big 5 audit firm would enhance the quality and reliability of firm's financial reporting practice (McConnell, 1984; Beattie and Fearnley, 1995; Maijor and Vanstraelen, 2006), as well as board assessment of management's proposition on firm's financial and strategic investment planning (Eichenseher and Shields, 1985; Knapp, 1987).

With respect to the impact of board of director's size (**NBDSZ**) on firm performance, OLS 3(ii)(b) result in Table 7.27 indicated a positive relationship between the two variables. This result suggests that the presence of a high number of board of director members will ensure the availability of greater human capital knowledge and skills for making informed board decisions. The inputs from each director will be valuable for achieving better firm performance (see Goodstein et al., 1994). In particular, Birnbaum (1994) noted that, firms operating in a business environment with a high level of uncertainty, due to lack of information or reliable resources, have a greater need for higher human capital knowledge in their board of directors.

OLS 3(ii)(a) result also indicated a significant positive relationship between main board firms (**MAINB**) and firm performance ($p = 0.1$). Namely, main board firms were companies with large paid-up capital [i.e. minimum of Malaysian Ringgit (RM) 60 million (i.e. USD 16.82

billion⁷³]). Notably the higher the firm's market capitalisation the higher its generation of firm value, given the availability of external funds to finance the firm's investment in assets (see Leftwich et al. 1981; Gray et al., 1995). Growing firms with large needs for outside financing may adopt better governance practice to obtain low cost of capital (Klapper and Love, 2003). On the other hand, there was also a positive relationship between firm market value of equity and the growth of firm earnings [See Table 6.10, Chapter 6]. This indicated that the market estimation of the firm value was parallel with the growth of firm earnings.

7.3 Conclusion

In this chapter the empirical findings relating to the research hypotheses proposed to examine the impact of board of directors' attributes, namely, independence, leadership structure and competency, on firm performance have been analysed and discussed. The presence of senior independent director on the firm's board was found to strengthen board's independence and had a significant positive impact on firm performance. Further, the director's years of experience as an independent director, his/her reputation and independence positively influenced the board's decision making.

Moreover, the presence of a senior independent director would ensure that newly appointed independent directors received adequate supervision in the performance of their oversight duties, which will further enhance new directors' abilities to conduct their responsibilities appropriately. On the other hand, the high presence of family-member directors on the firm's board was found detrimental to firm performance. Potentially their high presence may lead to

⁷³ See *ibid* 50.

greater expropriation of minority interests and domination of the of firm's board by their relatives.

On the other hand, this study found that board leadership enhanced firm performance when the independent director, founder or a non-executive director held the position as the board's chairman. Notably, independent board chairman ensures objectivity and credibility in board's judgements. In addition, the founder possesses the leadership and managerial skills given his/her experience and contribution in the setting up of the business. Furthermore, a non-executive director's business association with the firm allows him/her better understanding of the firm's business operation and to obtain cooperation and access to information from the firm's employees.

Moreover, directors with a professional and Doctor of Philosophy qualification had a positive impact on firm performance. Their attainment of higher knowledge and skills as well as their relevant industry experience contributed to the better management of firm assets and hence performance. In addition, directors which possessed finance qualification, law qualification and had attended the executive management programme organised by top business schools (namely Harvard, Stanford, Wharton, INSEAD and the London Business School) were important sources of financial, business and legal advice in the firm.

In terms of research model fitness, the board corporate governance models that used market value as a firm performance measure (i.e. Tobin's Q) had a higher F statistical value in comparison to accounting-based measure of firm performance (ROE) in most of the cases

observed. These observations have been widely recognised, namely by Morck et al., (1988), Bai et al., (2004) and Black et al., (2006), of Tobin's Q more closely linked with a firm's corporate governance practice than accounting rate of return. In addition Murphy (1985) gathered, the company performance measured in terms of shareholders return provided a better link with managerial performance. The subsequent chapter will continue with the analyses and discussions of the results of the impact of board-subcommittees attributes on firm performance.

Discussion of the current research findings has been restricted to significant results found in individual research model. With the collection of more corporate governance data in the future, the research could be examined as time series research and the data could be analysed using pooled regression approach. The next chapter 8 continues the analysis and discussion of the research models by focusing on the impact on firm performance of the board's subcommittees' attributes. In addition, chapter 8 will examine the robustness tests for board of directors' and board subcommittees research models.

Chapter 8

~Analyses of Results and Discussion II~

The Impact of Board Subcommittees' Attributes on Firm Performance

8.0 Introduction

In the preceding Chapter, the research hypotheses and models for board of directors' composition (OLS 1), leadership (OLS 2) and competency (OLS 3) impact on firm performance were analysed and discussed. This chapter continues the analysis and discussion of the research hypotheses and models, focusing on the impact of board subcommittees', namely, audit, nomination and remuneration committee attributes on firm performance. Chapter 8 begins, by analysing and discussing audit committee composition, leadership and competency influence on firm performance. Subsequently, the impact of nomination and remuneration committees' respective composition and structure on firm performance is analysed and discussed. In addition, the chapter discusses the robustness tests for findings derived from the board of directors and board subcommittees research model results.

8.1 Empirical Results of Board Sub-Committees' Attribute Impact on Firm Performance

This section presents the results of the multiple regression analysis and discussion of the impact of audit, nomination and remuneration committees' attributes on firm performance. As indicated in Chapter 7, the research was designed to evaluate the impact of firm corporate governance practice in the years 2002 and 2003, and the notations (a) and (b) represent observation of independent variables in 2002 and 2003, respectively.

8.2 Audit Committee and Firm Performance

The impact of audit committee's attributes is examined by investigating the influence of audit committee independence, leadership and competency on firm performance. The following subsections respectively present the results of the analysis of the audit committee research model OLS 4 (i.e. audit committee independence), OLS 5 (i.e. audit committee leadership), and OLS 6 (i.e. audit committee competency) [see Chapter 5, section 5.2.1.1]

8.2.1 *Audit Committee Independence and Firm Performance – OLS 4*

The impact of audit committee independence on firm performance was examined by the research models OLS 4(i), OLS 4(ii) and OLS 4(iii) [See Chapter 5, section 5.2.1.1]. Specifically, each model respectively examined the impact of certain compositions of independent directors on the board, namely the presence of wholly independent directors composition on the audit committee (AUDF), domination of independent director composition on the audit committee (AUGMJ), and majority independent director composition on the audit committee (AUDMJ), on firm performance. In particular, the investigations were undertaken by evaluating together in each model other factors that may have influenced the audit committee independent directors' effectiveness, namely, the presence of a senior independent director on the audit committee (ACSIN), the presence of at least one independent audit committee member with practising accountant experience (ACPI), the presence of at least one audit committee member with practising accountant experience (ACPACT), the presence of an audit committee chairman with practising accountant experience (APACH), the exclusion of Chief Executive Director, Chief Financial Officer and Managing Director from audit committee membership (AXCEO), the presence of a family-member director on the audit committee (ACFAM), the

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convening of a separate meeting between the audit committee's independent outside directors and external auditor (MTEXT), and the transparency of audit committee authority to report firm violation of Securities Commission, Stock Exchange, and other regulatory rules (RBRE). The following sub-sections will discuss the results of the three OLS 4 models respectively.

(I) Presence of Wholly Independent Directors on Audit Committee (AUDF) and Firm Performance – OLS 4(i)

Tables 8.1 and 8.2 respectively present the regression results derived from the OLS 4(i)(a) [i.e. regression of AUDF and specified audit committee independence variables in 2002 with respective firm performance 2002 and 2003] and the OLS 4(i)(b) model [i.e. regression of AUDF and specified audit committee independence variables in 2003 with respective firm performance 2003 and 2004].

Hypothesis HACIND 1 suggested that the whole composition of audit committee by independent directors (AUDF) will have a positive impact on firm performance (see Chapter 5, section 5.2.1.1). OLS 4(i)(a) and OLS 4(ii)(b) results pointed to the contrary. In most of the cases observed, the relationship between AUDF and firm performance was not statistically significant. However there existed a significant negative relationship between AUDF in 2002 and NROE in 2002 ($\beta = -0.53$; $p = 0.05$).

With respect to HACIND 4, the research hypothesis proposed that the presence of a senior independent director on the audit committee (ACSIN) has a positive impact on firm performance. The results of OLS 4(i)(a) and 4(i)(b) models revealed mixed significant relationships between the two respective variables [see Tables 8.1 and Table 8.2 respectively].

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Specifically, when the audit committee was comprised wholly of independent directors, there existed a significant negative relationship between ACSIN in 2002 and NTobin's Q in 2002 ($\beta = -0.22$; $p = 0.1$). On the other hand, there was a significant positive relationship between ACSIN in 2002 and NROE in 2003 ($\beta = 0.31$; $p = 0.05$), and between ACSIN in 2003 and NROE in 2003 ($\beta = 0.30$; $p = 0.05$).

In addition, HACIND 5 testing results [see Table 8.2, OLS 4(i)(b)] showed that, when the audit committee was comprised wholly of independent directors, there were four cases where the hypothesised positive relationship between the presence of at least one independent audit committee member with practising accountant experience (ACPI) and firm performance was supported. Specifically, there existed significant positive relationship between ACPI in 2003 and NTobin's Q in 2003 ($\beta = 0.13$; $p = 0.1$) and NROE in 2003 ($\beta = 0.14$; $p = 0.1$), and between ACPI in 2003 and NTobin's Q in 2004 ($\beta = 0.17$; $p = 0.1$) and NROE in 2004 ($\beta = 0.23$; $p = 0.01$).

It was hypothesised by HACIND 10 that the convening of a meeting between audit committee independent members and the external auditor (MTEXT) without executive member present will have a positive impact on firm performance. On the contrary, OLS 4(i)(b) result indicated that, when the audit committee was comprised wholly of independent director, there was a significant negative relationship between MTEXT in 2003 and NROE in 2003 ($\beta = -0.31$; $p = 0.05$).

Table 8.1: Audit Committee Independence and Firm Performance – OLS 4(i)(a)

**The Examination of the Presence of Wholly Independent Directors on Audit Committee (AUDF) in 2002 with Respective Firm Performance 2002 and 2003
(The Testing of HACIND 1 with HACIND 4, 5, 7, 10 and 11)**

AC = Audit committee, INED = Independent director, AUDF = AC is wholly composed of INED, ACSIN = Presence of senior independent director on AC, ACPI = At least one INED on AC has practising accountant experience, APACH = AC's Chairman has practising accountant experience, MTEXT = AC independent members conduct meeting with auditor without management member present at least once a year, RBRE = Transparency of AC authority to report firm's breach of regulatory rules, NATEND = Attendance rate of audit committee members at the committee's meetings, NFACF = Proportion of family member directors with accounting and finance background, NFAMD1 = Proportion of family member director, NASE1 = Total assets, NDEQ = Debt to equity ratio, MB = Main Board firms, PROP = Property industry, CONPRO = Consumer product industry, FIN = Finance Industry, 02 = Year 2002, 01 = Year 2003. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated a *VIF* level below 3 condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (*d*) indicated a value greater than the Durbin Watson derived upper limit (*du*); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All *t*-statistical values were significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
<i>Adj R</i> ²	0.2112		0.1664		0.1928		0.1750	
<i>R</i> ²	0.2865		0.2460		0.2698		0.2538	
<i>F</i>	3.8046		3.0910		3.5017		3.2227	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.0075	0.0339	0.1824	-0.8061	-0.3287	-1.4761	0.0001	0.0002
<i>Explanatory Variables</i>								
AUDF02	-0.1972	-0.9142	-0.5267	-2.3754**	0.3034	-1.3904	-0.1474	-0.6683
ACSIN02	-0.2154	-1.6983*	0.1780	1.3648	-0.1042	-0.8123	0.3137	2.4183**
ACPI02	-0.1990	-1.4378	0.0358	0.2519	-0.0612	-0.4373	-0.1818	-1.2845
APACH02	0.1110	0.6894	0.2025	1.2234	0.1555	0.9551	0.1989	1.2080
MTEXT02	0.1795	1.2942	-0.0612	-0.4288	0.2311	1.6467	-0.1742	-1.2278
RBRE02	0.0188	-0.1365	0.0941	0.6629	0.0537	0.3848	0.2779	1.9689*
<i>Control Variables</i>								
NASET02	-0.2260	-2.6193***	0.4353	4.9085***	-0.1762	-2.0189**	0.3660	4.1488***
NDEQ02	0.1510	2.0814**			0.3090	4.2112***	0.1319	1.7782*
NATEND02							-0.1223	-1.6545*
NFAMD102	0.2250	-2.5382**						
NFACF02							-0.2386	-2.1448**
<i>Industry Dummy</i>								
MB					0.3631	1.9767*		
PROP	-0.9916	-4.3947***			-0.8251	-3.6150***		
CONPRO			0.3280	1.6530*				
FIN					-0.5447	-2.0238**		

Table 8.2: Audit Committee Independence and Firm Performance -- OLS 4(i)(b)

**The Examination of the Presence of Wholly Independent Directors on Audit Committee (AUDF) in 2003 with Respective Firm Performance 2003 and 2004
(The Hypothesis Testing of HACIND 1 with HACIND 4, 5, 7, 10 and 11)**

AC = Audit committee, INED = Independent director, AUDF = AC is wholly composed of INED, ACSIN = Presence of senior independent director on AC, ACPI = At least one INED on AC has practising accountant experience, APACH = AC's Chairman has practising accountant experience, MTEXT = AC independent members conduct meeting with auditor without management member present at least once a year, RBRE = Transparency of AC authority to report firm's breach of regulatory rules, NINED = Proportion of independent directors on the Board, NASET = Total assets, NDEQ = Debt to equity ratio, MB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All F-statistical values were significant at the 0.1 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.1938		0.2275		0.0518		0.1213	
R ²	0.2707		0.3012		0.1444		0.2071	
F	3.5182		4.0846		1.5593		2.4131	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.2575	-1.1648	0.0212	0.0978	-0.1007	-0.4153	-0.0358	-0.1535
<i>Explanatory Variables (β)</i>								
AUDF03	-0.1842	-0.8025	0.0239	0.1062	-0.1495	-0.5938	-0.1939	-0.8005
ACSIN03	-0.1133	-0.8957	0.2988	2.4137**	-0.0244	-0.1758	0.0285	0.2137
ACPI03	0.1329	1.6958*	0.1412	1.8404*	0.1684	1.9584*	0.2293	2.7731***
APACH03	-0.1348	-0.9005	-0.0666	-0.4549	0.0880	0.5363	-0.1423	-0.9012
MTEXT03	0.1070	0.7630	-0.3117	-2.2705**	0.0609	0.3962	-0.1412	-0.9543
RBRE03	0.0878	0.6388	0.2688	1.9978*	-0.1729	-1.1470	-0.0082	-0.0566
<i>Control Variables</i>								
NASET03	-0.2311	-2.6052**	0.4182	4.8147***			0.2588	2.7651**
NDEQ03	0.3026	4.2687***					0.1242	1.6615*
NINED03	0.1196	1.6958*	-0.1742	-2.5243**				
<i>Industry Dummy</i>								
MB	0.3222	1.7555*						
PROP	-0.8251	-3.6501***	-0.4005	-1.8099*	-0.6148	-2.4799**	-0.4569	-1.9160*
CONSTR							-0.4838	-1.7881*
FIN	-0.4575	1.7233*			-0.6029	-2.0708**		

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HACIND 11 hypothesised that when the firm discloses in its audit committee report that its audit committee has the authority to report to the Exchange in the event of a firm breaching the Exchange's ruling (RBRE), such conduct signifies firm's transparency of corporate governance commitment and hence will have a positive impact on firm performance. OLS 4(i)(a) and 4(i)(b) results indicated that, when the audit committee was composed wholly of independent director, there existed significant positive relationship between RBRE in 2002 and NROE in 2003 ($\beta = 0.28$; $p = 0.1$), and between RBRE in 2003 and NROE in 2003 ($\beta = 0.27$; $p = 0.1$).

On the other hand, OLS 4(i)(a) and OLS 4(i)(b) results were not statistically significant to support hypotheses HACIND 7.

**(II) Audit Committee Domination Composition of Independent Directors (AUGMJ) and Firm Performance
- OLS 4(ii)**

Tables 8.3 and 8.4 respectively presents the regression results for the OLS 4(ii)(a) model [i.e. regression of AUGMJ and specified audit committee independence variables in 2002 with respective firm performance 2002 and 2003] and the OLS 4(ii)(b) model [i.e. regression of AUGMJ and specified audit committee independence variables in 2003 with respective firm performance 2003 and 2004].

It was hypothesised by HACIND 2 (see Chapter 5 section 5.2.1.1) that the domination of independent directors on the audit committee (AUGMJ) will have a positive impact on firm performance. However, OLS 4(ii)(a) result did not support this hypothesis. There existed

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significant negative relationship between AUGMJ in 2002 with NTobin's Q in 2003 ($\beta = -0.71$; $p = 0.01$).

With respect to HACIND 4 testing, OLS 4(ii)(a) and 4(ii)(b) results respectively revealed mixed significant relationships between the presence of a senior independent director on the audit committee (ACSIN) and firm performance. Namely, when the audit committee was dominated by independent directors there existed significant negative relationship between the presence of a senior independent director on the audit committee (ACSIN) in 2002 and NTobin's Q in 2002 ($\beta = -0.24$; $p = 0.1$). On the contrary, a significant positive relationship was found between ACSIN in 2002 and NROE in 2003 ($\beta = 0.31$; $p = 0.05$), and between ACSIN in 2003 and NROE in 2003 ($\beta = 0.30$; $p = 0.05$). These results were consistent with OLS 4(i)(a) and 4(i)(b) findings of mixed significant relationships between ACSIN and firm performance.

Moreover, according to the result derived from OLS 4(ii)(b), when the audit committee was dominated by independent directors, there existed significant positive relationship between the presence of at least one independent audit committee member with practising accountant experience (ACPI: HACIND 5) and firm performance. This relationship was found between ACPI in 2003 and NTobin's Q in 2003 ($\beta = 0.13$; $p = 0.1$) and NROE in 2003 ($\beta = 0.15$; $p = 0.05$), and between ACPI in 2003 and NROE in 2004 ($\beta = 0.20$; $p = 0.05$). Similar findings were gathered from the results of OLS 4(i)(b) model of a significant positive relationship between ACPI and firm performance.

For the testing of HACIND 6, the result derived from OLS 4(ii)(b) [see Table 8.4] revealed that, when the audit committee was dominated by independent directors, a significant positive

Table 8.3: Audit Committee Independence and Firm Performance -- OLS 4(i)(a)

**The Examination of Audit Committee Domination Composition of Independent Directors (AUGMJ) in 2002 with Respective Firm Performance 2002 and 2003
(The Testing of HACIND 2 with HACIND 4, 5, 6, 7, 8, 9, 10 and 11)**

AC = Audit committee, INED = Independent director, AUGMJ = Presence of more than majority of INED on AC, ACSIN = Presence of senior independent director on AC, ACPI = At least one INED on AC has practising accountant experience, ACPACT = At least one AC member has practising accountant experience, APACH = AC's Chairman has practising accountant experience, AXCEO = Exclusion of CEO, CFO and/or managing director from AC, ACFAM = Presence of family-member director on AC, MTEXT = AC independent members conduct meeting with auditor without management member present at least once a year, RBRE = Transparency of AC authority to report firm's breach of regulatory rules, NASET = Total assets, NDEQ = Debt to equity ratio, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All t-statistical values were significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.1927		0.1387		0.2139		0.1586	
R ²	0.2698		0.2209		0.2890		0.2390	
F	3.5009		2.6865		3.8513		2.9753	
Intercept (α)	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
	0.4278	1.1509	0.0695	0.1811	0.3220	0.8781	0.2219	0.5848
<i>Explanatory Variables (β)</i>								
AUGMJ02	-0.3804	-1.6126	-0.0759	-0.3115	-0.7106	-3.0529***	-0.0184	-0.0764
ACSIN02	-0.2403	-1.8958*	0.1749	1.3362	-0.1293	-1.0342	0.3092	2.3902**
ACPI02	-0.1686	-1.2896	0.0637	0.4719	-0.0592	-0.4590	-0.0986	-0.7387
ACPACT02	0.1259	0.5651	-0.1653	-0.7185	0.0628	0.2856	-0.1748	-0.7687
APACH02	0.0408	0.2518	0.2131	1.2719	0.0854	0.5338	0.2171	1.3112
AXCEO02	-0.1676	-0.9381	-0.0843	-0.4567	-0.0352	-0.1997	-0.1254	-0.6878
ACFAM02	-0.0595	-0.4148	-0.0171	-0.1152	0.1058	0.7475	-0.0764	-0.5221
MTEXT02	0.1369	0.9641	-0.0823	-0.5613	0.1991	1.4218	-0.1877	-1.2953
RBRE02	0.0261	0.1878	0.1270	0.8833	0.1101	0.8018	0.2711	1.9074*
<i>Control Variables</i>								
NASET02	-0.2226	-2.5392***	0.4173	4.6075***	-0.1664	-1.9226*	0.3510	3.9212***
NDEQ02	0.1408	1.9192***			0.2999	4.1434***	0.1333	1.7806*
<i>Industry Dummy</i>								
PROP	-0.9897	-4.3360***			-0.9095	-4.0380***	-0.3929	-1.6862*
CONSTR					0.4779	1.9327*		
FIN					-0.5207	-2.0114**		

Table 8.4: Audit Committee Independence and Firm Performance -- OLS 4(ii)(b)

**The Examination of Audit Committee Domination Composition of Independent Directors (AUGMJ) in 2003 with Respective Firm Performance 2003 and 2004
(The Testing of HACIND 2 with HACIND 4, 5, 6, 7, 8, 9, 10 and 11)**

AC = Audit committee, INED = Independent director, AUGMJ = Presence of more than majority of INED on AC, ACSIN = Presence of senior independent director on AC, ACPI = At least one INED on AC has practising accountant experience, ACPACT = At least one AC member has practising accountant experience, APACH = AC's Chairman has practising accountant experience, AXCEO = Exclusion of CEO, CFO and/or managing director from AC, ACFAM = Presence of family-member director on AC, MTEXT = AC independent members conduct meeting with auditor without management member present at least once a year, RBRE = Transparency of AC authority to report firm's breach of regulatory rules, NINED = Proportion of independent directors on the Board, MB = Main Board firms, NASET = Total assets, NDEQ = Debt to equity ratio, PROP = Property industry, CONSTR = Construction industry, CONPRO = Consumer product industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All F-statistical values were significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2144		0.2338		0.0673		0.1319	
R ²	0.2894		0.3069		0.1584		0.2167	
F	3.8586		4.1964		1.7386		2.5556	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.5969	1.0928	-0.3575	-0.6627	0.2538	0.4216	-0.2680	-0.4619
<i>Explanatory Variables (β)</i>								
AUGMJ03	-0.2482	-0.7618	0.4347	1.3510	-0.0808	-0.2250	-0.0269	-0.0776
ACSIN03	-0.0867	-0.6885	0.2996	2.4098**	-0.0138	-0.0996	-0.0188	-0.1404
ACPI03	0.1318	1.7847*	0.1523	2.0888**	0.1292	1.5882	0.2019	2.5736**
ACPACT03	0.1758	0.7212	-0.0295	-0.1227	0.4053	1.5088	0.4982	1.9235*
APACH03	-0.1387	-0.9618	-0.0578	-0.4061	0.0284	0.1786	-0.1781	-1.1622
AXCEO03	-0.8516	-2.4627**	0.0261	0.0765	-0.6360	-1.6692*	-0.2131	-0.5802
ACFAM03	-0.0145	-0.1018	-0.1123	-0.7993	-0.0524	-0.3345	0.0946	0.6258
MTEXT03	0.1185	0.8574	-0.3245	-2.3770**	-0.0808	-0.2250	-0.1553	-1.0579
RBRE03	0.0953	0.6988	0.2609	1.9372*	-0.0138	-0.0996	-0.0095	-0.0652
<i>Control Variables</i>								
NASET03	-0.2170	-2.5261**	0.4256	5.0183***	-0.6223	-2.5250**	0.2556	2.8020***
NDEQ03	0.3135	4.5039***					0.1405	1.8997*
NINED03	0.1422	2.1321**	-0.1823	-2.7673***				
<i>Industry Dummy</i>								
MB	0.3361	1.8610*						
PROP	-0.7948	-3.5535***	-0.4081	-1.8474*	-0.5703	-2.0089**	-0.4796	-2.0185**
CONPRO							-0.5599	-2.0878**
CONSTR							-0.3625	-1.7334*
FIN	-0.4598	-1.7844*						

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relationship was found between the presence of at least one audit committee member with practising accountant experience (ACPACT) in 2003 and NROE in 2004 ($\beta = 0.50$; $p = 0.1$).

With regard to testing of HACIND 8, the results derived from OLS 4(ii)(b) indicated that, when the audit committee was dominated by independent directors, there was a significant negative relationship respectively, between the exclusion of CEO, Chief Operating Officer and/or Managing Director from audit committee membership (AXCEO) in 2003 and NTobin's Q in 2003 ($\beta = -0.85$; $p = 0.05$), and NTobin's Q in 2004 ($\beta = -0.64$; $p = 0.1$).

In addition, OLS 4(ii)(b) result indicated that, when the audit committee was composed of more than majority independent director, there existed significant negative relationship between the convening of a meeting with only independent directors on the audit committee and the auditor as attendees (MTEXT: HACIND 10) in 2003 and NROE in 2003 ($\beta = -0.32$; $p = 0.05$). This result failed to support the hypothesis of HACIND 10 which postulated positive relationship between the two respective variables. Similar finding was also observed from earlier OLS 4(i)(b) model result of the significant negative relationship between MTEXT and firm performance .

Further testing of HACIND 11 [see result of OLS 4(ii)(b) in Table 8.4] indicated that, when the audit committee was composed of more than majority independent director, there was a significant positive relationship between the transparency of the audit committee's authority to report firm violation of Exchange ruling to the Exchange (RBRE) in 2002 and NROE in 2003 ($\beta = 0.27$; $p = 0.1$), and between RBRE in 2003 and NROE in 2003 ($\beta = 0.26$; $p = 0.1$). These

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results were consistent with previous OLS 4(i)(a) and 4(i)(b) findings of a significant positive relationship between RBRE and firm performance.

On the other hand, OLS 4(ii)(a) and OLS 4(ii)(b) results were not statistically significant to support hypotheses HACIND 7 and 9. Similar finding was derived from OLS 4(i)(a) and (b) models testing of HACIND 7.

(III) Audit Committee Majority Independent Composition (AUDMJ) and Firm Performance – OLS 4(iii)

Tables 8.5 and 8.6 respectively presents the regression results of model OLS 4(iii)(a) [i.e. regression of AUDMJ and specified audit committee independence variables in 2002 with respective firm performance 2002 and 2003] and OLS 4(iii)(b) [i.e. regression of AUDMJ and specified audit committee independence variables in 2003 with respective firm performance 2003 and 2004].

HACIND 3 (see Chapter 5 section 5.2.1.1) suggested that the majority composition of independent directors on the audit committee (AUDMJ) will have a positive impact on firm performance. OLS 4(iii)(a) result revealed a significant negative relationship between AUDMJ in 2002 and NTobin's Q in 2003 ($\beta = -0.57$; $p = 0.05$) [see Table 8.5] which did not support the hypothesis.

OLS 4(iii)(a) and 4(iii)(b) results derived from testing HACIND 4 indicated that, when the audit committee was composed of majority independent directors, there existed mixed significant findings on the relationship between the presence of a senior independent director on the audit

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committee (ACSIN) and firm performance. Specifically, a significant negative relationship was found between ACSIN in 2002 and NTobin's Q in 2002 ($\beta = -0.23$; $p = 0.1$). On the other hand, a significant positive relationship was observed between ACSIN in 2002 and NROE in 2003 ($\beta = 0.31$; $p = 0.05$), and between ACSIN in 2003 and NROE in 2003 ($\beta = 0.29$; $p = 0.05$). These results were consistent with the earlier OLS 4(i)(a) and (b), and 4(ii)(a) and (b) models findings of mixed significant relationship between ACSIN and firm performance.

Furthermore, the testing of HACIND 5 revealed that [see Table 8.6 of OLS 4(iii)(b) research model], when the audit committee was composed of majority independent director, a significant positive relationship was found between the presence of at least one independent audit committee member with practising accountant experience (ACPI) and firm performance. Namely, there existed a significant positive relationship between ACPI in 2003 and NTobin's Q in 2003 ($\beta = 0.13$; $p = 0.1$), NROE in 2003 ($\beta = 0.15$; $p = 0.05$) and NROE in 2004 ($\beta = 0.20$; $p = 0.05$), respectively. Similar results were also gathered from previous OLS 4(i)(b) and 4(ii)(b) models findings of respective variables.

In addition, the OLS 4(iii)(b) result derived from testing HACIND 6 indicated that when the audit committee was composed of majority independent director, there existed a significant positive relationship between the presence of at least one audit committee member with practising accountant experience (ACPACT) in 2003 and NROE in 2004 ($\beta = 0.51$; $p = 0.1$).

This result was consistent with OLS 4(ii)(b) model finding of ACPACT's significant positive impact on firm performance.

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Accordingly, OLS 4(iii)(b) results showed that, when the audit committee was composed of majority independent director, there was a significant negative relationship between the exclusion of CEO, Chief Operating Officer and/or Managing Director from audit committee membership (AXCEO:HACIND 8) in 2003 and NTobin's Q in 2003 ($\beta = -0.83$; $p = 0.05$). This finding was consistent with previous OLS 4(ii)(b) model finding of a significant negative relationship between AXCEO and firm performance.

OLS 4(iii)(b) model result [see Table 8.6] derived from testing HACIND 10 revealed that, when the audit committee was composed of majority independent director, there was significant negative relationship between the convening of a meeting with only independent directors on the audit committee and the auditor as attendees (MTEXT) in 2003 and NROE in 2003 ($\beta = -0.32$; $p = 0.05$). This result was consistent with OLS 4(i)(b) and OLS 4(ii)(b) models finding on MTEXT's significant negative impact on firm performance.

With respect to HACIND 11 testing, OLS 4(iii)(a) and (b) model results indicated that, when the audit committee was composed of majority independent directors, there existed a significant positive relationship between the transparency of the audit committee's authority to report firm violation of Exchange rulings to the Exchange (RBRE) in 2002 and NROE in 2003 ($\beta = 0.27$; $p = 0.1$) and between RBRE in 2003 and NROE in 2003 ($\beta = 0.27$; $p = 0.1$). These results were consistent with previous OLS 4(i)(a) and (b), and OLS 4(ii)(a) and (b) models findings of a significant relationship between RBRE and firm performance.

Table 8.5: Audit Committee Independence and Firm Performance -- OLS 4(iii)(a)

The Examination of Audit Committee Majority Independent Composition (AUDMJ) in 2002 with Respective Firm Performance 2002 and 2003

(The Testing of HACIND 3 with HACIND 4, 5, 6, 7, 8, 9, 10 and 11)

AC = Audit committee, INED = Independent director, AUDMJ = Presence of majority of INED on AC, ACSIN = Presence of senior independent director on AC, ACPI = At least one INED on AC has practising accountant experience, ACPACT = At least one AC member has practising accountant experience, APACH = AC's Chairman has practising accountant experience, AXCEO = Exclusion of CEO, CFO and/or managing director from AC, ACFAM = Presence of family-member director on AC, MTEXT = AC independent members conduct meeting with auditor without management member present at least once a year, RBRE = Transparency of AC authority to report firm's breach of regulatory rules, NINED = Proportion of independent directors on the Board, MB = Main Board firms, NASET = Total assets, NDEQ = Debt to equity ratio, MB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 01 = Year 2003. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_u); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All F-statistical values were significant at the 0.001 level]

Performance Measures	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.1894		0.1394		0.1943		0.1593	
R ²	0.2668		0.2216		0.2712		0.2395	
F	3.4483		2.6970		3.5263		2.9847	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	0.4238	1.0884	-0.0999	-0.2489	0.2218	0.5713	0.1235	0.3115
<i>Explanatory Variables (β)</i>								
AUDMJ02	-0.3687	-1.3353	0.1476	0.5186	-0.5669	-2.0595**	0.1109	0.3942
ACSIN02	-0.2337	-1.8380*	0.1710	1.3049	-0.1200	-0.9467	0.3065	2.3668**
ACPI02	-0.1746	-1.3352	0.0550	0.4084	-0.0746	-0.5725	-0.1032	-0.7747
ACPACT02	0.1337	0.5930	-0.2009	-0.8648	0.0569	0.2532	-0.1961	-0.8538
APACH02	0.0493	0.3038	0.2162	1.2919	0.1021	0.6305	0.2183	1.3201
AXCEO02	-0.1866	-1.0492	-0.1040	-0.5676	-0.0795	-0.4485	-0.1356	-0.7488
ACFAM02	-0.0641	-0.4463	-0.0157	-0.1064	0.0983	0.6861	-0.0753	-0.5148
MTEXT02	0.1386	0.9741	-0.0844	-0.5755	0.2010	1.4174	-0.1890	-1.3047
RBRE02	0.0258	0.1847	0.1252	0.8709	0.1085	0.7799	0.2700	1.9007*
<i>Control Variables</i>								
NASET02	-0.2262	-2.5770**	0.4108	4.5419***	-0.1762	-2.0133**	0.3474	3.8867***
NDEQ02	0.1378	1.8717*			0.2966	4.0404***	0.1356	1.8076*
NINED02							-0.1157	-1.6939*
<i>Industry Dummy</i>								
MB					0.3179	1.7306*		
PROP	-0.9626	-4.2368***			-0.8507	-3.7557***	-0.3830	-1.6554*
CONSTR					0.4706	1.8795*		
FIN					-0.5194	-1.9820*		

Table 8.6: Audit Committee Independence and Firm Performance -- OLS 4(iii)(b)
The Examination of Audit Committee Majority Independent Composition (AUDMJ) in 2003 with Respective Firm Performance 2003 and 2004
(The Testing of HACIND 3 with HACIND 4, 5, 6, 7, 8, 9, 10 and 11)

AC = Audit committee, INED = Independent director, AUDMJ = Presence of majority of INED in AC, ACSIN = Presence of senior independent director on AC, ACPI = At least one INED on AC has practising accountant experience, ACPACT = At least one AC member has practising accountant experience, APACH = AC's Chairman has practising accountant experience, AXCEO = Exclusion of CEO, CFO and/or managing director from AC, ACFAM = Presence of family-member director on AC, MTEXT = AC independent members conduct meeting with auditor without management member present at least once a year, RBRE = Transparency of AC authority to report firm's breach of regulatory rules, NINED = Proportion of independent directors on the Board, MB = Main Board firms, NASET = Total assets, NDEQ = Debt to equity ratio, PROP = Property industry, CONSTR = Construction industry, CONPRO = Consumer product industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) All F-statistical values were significant at the 0.05 level]

Performance Measures	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2134		0.2282		0.0689		0.1325	
R ²	0.2884		0.3019		0.1598		0.2172	
F	3.8413		4.0978		1.7574		2.5632	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.0016	-0.0021	-0.3118	-0.4104	-0.2518	-0.2985	-0.0531	-0.0652
<i>Explanatory Variables (β)</i>								
AUDMJ03	0.3757	0.5665	0.4040	0.6149	0.4515	0.6188	-0.2556	-0.3632
ACSIN03	-0.0895	-0.7096	0.2933	2.3478**	-0.0182	-0.1313	-0.0160	-0.1192
ACPI03	0.1341	1.8159*	0.1495	2.0438**	0.1304	1.6045	0.2018	2.5745**
ACPACT03	0.1516	0.6149	-0.0441	-0.1804	0.3798	1.4004	0.5114	1.9552*
APACH03	-0.1351	-0.9339	-0.0465	-0.3242	0.0350	0.2200	-0.1826	-1.1890
AXCEO03	-0.8287	-2.3952**	0.0130	0.0380	-0.6202	-1.6293	-0.2182	-0.5942
ACFAM03	-0.0116	-0.0813	-0.1377	-0.9767	-0.0578	-0.3689	0.1005	0.6658
MTEXT03	0.1111	0.8028	-0.3208	-2.3411**	0.0712	0.4679	-0.1535	-1.0459
RBRE03	0.0929	0.6809	0.2693	1.9936*	-0.1990	-1.3263	-0.0109	-0.0752
<i>Control Variables</i>								
NASET03	-0.2119	-2.4659**	0.4227	4.9665***			0.2545	2.7910***
NDEQ03	0.3152	4.5133***					0.1383	1.8665*
NINED03	0.1220	1.7936*	-0.1763	-2.6169***				
<i>Industry Dummy</i>								
MB	0.3332	1.8418*						
PROP	-0.8053	-3.6014***	-0.3965	-1.7903*	-0.6278	-2.5519**	-0.4788	-2.0178**
CONSTR							-0.5562	-2.0739**
CONPRO							-0.3600	-1.7306*
FIN	-0.4744	-1.8384*			-0.5821	-2.0504**		

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Table 8.7: Summary of Findings of the Impact of Audit Committee Independence on Firm Performance

<i>Audit Committee Independence and Firm Performance---OLS 4</i>								
<i>Wholly Independent Director Composition (AUDF)</i>			<i>More than Majority Independent Director Composition (AUGM)</i>			<i>Majority Independent Director Composition (AIDM)</i>		
OLS 4(i)	Postulated Relationship (+/-/?)	Result	OLS 4(ii)	Postulated Relationship (+/-/?)	Result	OLS 4(iii)	Postulated Relationship (+/-/?)	Result
HACIND 1: Wholly INED on AC composition [AUDF]	+	Not Supported	HACIND 2: Domination of INED on AC composition [AUGM]	+	Not Supported	HACIND 3: Majority of INED in AC composition [AUDM]	+	Not Supported
HACIND 4: Presence of SRINED on AC [ACSIN]	+	Supported	HACIND 4: Presence of SRINED on AC [ACSIN]	+	Supported	HACIND 4: Presence of SRINED on AC [ACSIN]	+	Supported
HACIND 5: Presence of at least one independent AC member with PAE [ACPI]	+	Supported	HACIND 5: Presence of at least one independent AC member with PAE [ACPI]	+	Supported	HACIND 5: Presence of at least one independent AC member with PAE [ACPI]	+	Supported
			HACIND 6: Presence of at least one AC member with PAE [ACPACT]	+	Supported	HACIND 6: Presence of at least one AC member with PAE [ACPACT]	+	Supported
HACIND 7: Presence of AC's Chairman with PAE [APACH]	+	Not Supported	HACIND 7: Presence of AC's Chairman with PAE [APACH]	+	Not Supported	HACIND 7: Presence of AC's Chairman with PAE [APACH]	+	Not Supported
			HACIND 8: Exclusion of CEO, CFO and MD from AC [AXCEO]	+	Not Supported	HACIND 8: Exclusion of CEO, CFO and MD from AC [AXCEO]	+	Not Supported
			HACIND 9: Presence of FAMDI on AC [ACFAM]	?	?	HACIND 9: Presence of FAMDI on AC [ACFAM]	?	?
HACIND 10: AC's Independent Directors Conduct a meeting with auditors without management presence [MTEXT]	+	Not Supported	HACIND 10: AC's Independent Directors Conduct a meeting with auditors without management presence [MTEXT]	+	Not Supported	HACIND 10: AC's Independent Directors Conduct a meeting with auditors without management presence [MTEXT]	+	Not Supported
HACIND 11: Transparency of AC Authority to Report to Exchange of Firm Violation of Regulations [RBRE]	?	Positive Relationship	HACIND 11: Transparency of AC Authority to Report to Exchange of Firm Violation of Regulations [RBRE]	?	Positive Relationship	HACIND 11: Transparency of AC Authority to Report to Exchange of Firm Violation of Regulations [RBRE]	?	Positive Relationship

Notes: AC = Audit Committee; INED = Independent Director; SRINED = Senior Independent Director; CEO = Chief Executive Director; CFO = Chief Financial Officer. COO = Chief Operating Officer; MD = Managing Director; ACF = Accounting and Finance; ACPACT = Practising Accountant Experience

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On the other hand the results of OLS 4(iii)(a) and OLS 4(iii)(b) model results were not statistically significant to support hypotheses HACIND 7 and 9. These findings were also similar to the results gathered by OLS 4(i)(a) and (b) models when testing HACIND 7, and OLS 4(ii)(a) and (b) models when testing HACIND 7 and HACIND 9.

Table 8.7 presents the summary of findings of the impact of audit committee independence on firm performance.

8.2.1.1 Discussions of the Impact of Audit Committee Independence on Firm Performance --- OLS 4(i), 4(ii) and 4(iii) Results.

(I) Independent Directors' Composition on Audit Committee (i.e. AUDF, AUGMJ, AUDMJ)

As reported in section 8.2.1 (I), (II) and (III) the extent of audit committee independence, namely, the presence of wholly independent directors (AUDF), more than majority independent directors (AUGMJ) or majority independent directors (AUDMJ) on the committee had no significant impact on firm performance in most of the cases observed. The significant relationship found between AUDF, AUGMJ and AUDMJ and firm performance indicated their negative association (see OLS 4 results in Tables 8.1, 8.3 and 8.5 respectively).

The underlying purpose for the formation of an audit committee is to conduct focused reviews and detailed discussions of management's financial activities, reporting practice and internal control procedures (see POB, 1993; Lublin and MacDonald, 1998; BRC, 1999; MCCG, 2001). The delegation of board of director financial oversight responsibilities to the audit committee (see POB, 1993) should ensure the effectiveness of board evaluations and decisions on firms'

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financial related issues. In particular, the committee should be able to allocate a specific amount of time and attention to perform its respective duties appropriately (MCCG, 2001).

Moreover, the governing of the firm's activities against corporate fraud, namely, financial statement fraud, underscores the board's fiduciary duty to safeguard shareholders' investment in the firm (Uzun et al., 2004). As the financial oversight committee of the board, the audit committee has a critical role to protect shareholders' interests against management's misappropriation of firm's asset through its evaluation of management's financial transactions (Verschoor et al., 2002). Prowse (1998) noted that lack of accountability of firms' owner-managers was one of the causes of financial problems in East Asian corporations during the 1997 economic crisis.

In addition, studies by Claessens et al., (1998, 1999), Johnson et al., (2000) and Mitton (2002) studies on the corporate governance of East Asian corporations found that the presence of owner-managers/family-members controlling ownership in East Asian corporations increased the vulnerability of minority shareholders' interests being expropriated by them. According to Johnson et al., (2000), even though the ownership and management of firms' activities by the principal owners overcome the agency problem in separate owner and management firms, owner-managers may have their own personal motives and may undertake actions that are in the best interests of their family members but not shareholders of the firms as a whole. Hence, the independence of the audit committee in Malaysian corporations is crucial to counter the self-motive activities of owner-managers and management in general.

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Further, Lublin and MacDonald (1998) noted that audit committee members' ineffectiveness in conducting their duties may increase the propensity of corporate failure, subsequently causing loss in shareholders' investments and confidence in the credibility of the board of director's, particularly audit committee governing efforts. Also, the extent of influence of audit committee independent members' views and opinions on the board's decision, and hence firm performance, may be affected by their size (namely, the AUDF, AUGMJ and AUDMJ) [see, for instance the Smith Report, 2003], possession of relevant financial knowledge and skills (see Knapp, 1987) and the presence of other independent directors who are not audit committee members but possess financial knowledge and skills (see Kirk and Siegel, 1996).

Moreover, Klein (1998) argued that independent directors should be members of monitoring and controlling board subcommittees, such as audit, nomination and remuneration committees. In particular, she argued that executive directors' membership of the remuneration committee would have less impact on firm performance in comparison to executives' presence on the investment committee. This is because in the latter committee, executives are assigned to perform a duty that is relevant to their depth of knowledge of firm operations and business opportunities, whereas in the former committee, executives' impartiality when evaluating executives' compensation scheme is less likely to be assured (Yermack, 1997) given their tendency to set high remunerations for themselves (see the Greenbury Report, 1995).

In addition, the productivity of the audit committee team is affected by the collective commitment of its members to fulfil their oversight duties responsibly and the sufficient co-operation of management in supplying required information to ensure effective audit committee

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decision-making (DeZoort, 1998). Importantly, the presence of a higher proportion of independent director on the audit committee will facilitate the deliberation of objective and impartial evaluation of the firm's business and financial risks and vigilance, namely, by challenging management's unwarranted proposition on firms' investment strategies (see Cohen and Hanno, 2000; Bédard et al., 2004).

Beasley (1996) and Carcello and Neal (2000) also found that the presence of a high proportion of affiliated directors on the audit committee will affect the auditor's decision to issue a going concern report due to the respective committee members' economic dependence or business dealings with the firm's management. Furthermore, auditors' independence and effectiveness will be impaired when their actions are dictated by management pressure, primarily on their fees and prospective employment with the firm (see Teoh, 1992; Geiger et al., 1998). In light of this, MCCG (2001) emphasised the importance of audit committee members having full access to the firm's resources and information and external professional advice to allow the committee to conduct its duties appropriately.

Moreover, Daily and Schwenk (1996) stressed the imperativeness of CEO-board members' cooperation in the firm's management, particularly in providing access to quality firm information (see Ezzamel and Watson, 1997; Dalton et al., 1998) and their goals' congruence (see Pye and Pettigrew, 2005). As argued by Goodwin (2003) the effectiveness of the audit committee independent members' oversights may be affected by their inability to gather relevant and sufficient information and lack of awareness of the impact of the firm's business relationships on the firm's financial performance.

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MCCG (2001) in its Best Practices guidelines for corporate governance indicated that the board of directors can decide whether to grant executive power to its subcommittee or not. Where such power is not granted, subcommittees' authorities are restricted to the examination of particular issue and they must present their findings to the board for further actions. The non-granting of executive power to the audit committee to act on the board's behalf was indicated in the audit committee report of some of the sampled companies in this study and may be one of the reasons for the non-significant relationship between audit committee independence and firm performance.

The effectiveness of the audit committee members, particularly independent director members could be enhanced with the implementation of on-going assessment and evaluation of committee members' performance of audit committee duties. With respect to the current study, respectively in year 2002 and 2003, 100 and 103 of the sampled companies indicated the exercised of such peer review practice on their audit committee members (see the companies' Audit Committee Report 2002 and 2003). More importantly, since the evaluation was undertaken by the companies on average every three years, they need to replace poor performance member with new director who is competent and committed to do the audit committee job.

In addition, directors would undertake their responsibilities seriously when there is legal penalties for the consequence loss incurred by the vested parties as a result of their failure to fulfil assigned duties with due care (see Singh and Harianto, 1989; Higgs Report. 2003; MAICSA, 2004). In this case, further monitoring of companies directors performance of fiduciary duties and conducts by Malaysian Securities Commission, Malaysia Bourse Securities

Limited, Companies Commission of Malaysia would ensure directors vigilance and active participation when undertaking their responsibilities and hence safeguarding shareholders interests in the firm.

(II) Senior Independent Director Presence on Audit Committee (ACSIN)

As reported in section 8.2.1 (I), (II) and (III) [see OLS 4(i)(a) and (b), 4(ii)(a) and (b) and 4(iii)(a) and (b) results in Tables 8.1 to 8.6 respectively] the presence of a senior independent director on the audit committee, whether composed of fully independent (AUDF), more than majority independent (AUGMJ), or majority independent (AUDMJ) directors had a significant negative and positive impact on firm performance. Specifically, when the impact of the presence of senior independent director on audit committee (ACSIN) was observed in the year he/she was appointed, the result indicated significant negative relationship between ACSIN and firm performance. On the hand, further investigation on ACSIN impact on subsequent year performance revealed a significant positive relationship between the two variables.

MCCG (2001: 35) identifies a senior independent director as someone who possesses the necessary calibre, experience and independence qualities to whom other independent directors may refer to express freely their concerns about the firm's governance practices. Furthermore, the Higgs Report (2003) stated that, the establishment of a senior independent director role will enhance communication between the board and shareholders, such that the shareholders might directly approach the senior independent director to clarify issues pertaining to the firm. In the case of the current study, many of the firms which had appointed a senior independent director had enclosed in their corporate governance statement the contact number and address of the

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senior independent director, as part of their governance initiatives that aims to facilitate shareholders' communication with the board of directors.

In addition, the appointment of senior independent director on the firm's board of directors was proposed by MCCG and imposed by MBSB's listing requirement on January 2001. Eventually, as the investors' and firms' knowledge and awareness of the function and significance of governing mechanisms expanded, they would supported the imperativeness of senior independent director invaluable corporate governance experience on audit committee, notably in establishing relevant, reliable and fair representation of financial reporting information.

Specifically, DeZoort et al., (2001) found audit committee members' corporate governance experience, namely years of experience as independent directors (which applied to senior independent directors) had influenced on their exercise of independent judgements, particularly in resolving auditor-management disputes, given their extent of exposure and awareness of issues affecting auditor-management disagreement⁷⁴. With respect to the current study, further examination on the profiles of the respective senior independent director revealed that, majority of them were not from accounting and/or finance backgrounds. Even though, they were experienced independent director and recognised for their credibility. Hence their corporate governance experience is relevant and substantial in assisting their performance of oversight duties in the company with weak internal control (Millichamp, 2002).

⁷⁴ For instance in relation to the assessment of management accounting treatment of assets, liabilities, expenses, profit and/or loss items (see Knapp, 1987; DeZoort and Salterio, 2001).

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Importantly, senior independent director contribution to the effectiveness of audit committee performance of tasks and subsequently quality of financial information and reporting produced, and hence firm performance, was signified by his/her suitability as negotiator and mediator in auditor-management disputes concerning audit planning or evaluation of audit results, as well as improving and facilitating auditor-management cooperation and relationship.

Nevertheless, without clear comprehension of the accounting issues at hand (due to his/her lack of knowledge on this area), the senior independent director may not be able to provide critical evaluation on firm's accounting practice (see for instance Bonner, 1990; Bonner and Lewis, 1990; Libby and Luft, 1993; DeZoort, 1998; McDaniel et al., 2002). Unless the auditor is required to be presence in each of the audit committee meeting, the decisions on firm financial position and reporting practice are made by the audit committee members including the senior independent director member. In particular, their decision will be influenced by the information they have gathered and their extent of understanding and experience of accounting procedures.

Also, OLS 4(i), (ii) and (iii) results further explain the significant contribution of senior independent director at board level [see section 7.2.1.1 (III)], since there, he/she would be dealing with broader corporate governance issues affecting the company (see Bonner and Lewis, 1990; Uzzi, 1996; Higgs Report, 2003). Nonetheless, since companies remunerated their directors based on their corporate experience (see companies corporate governance statement on remuneration committee activities)⁷⁵ the shareholders should insist their companies to provide

⁷⁵ Firms which did not appoint senior independent director in their board are required to disclose valid justification for their action.

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appropriate and adequate accounting training to senior independent director to fully utilise their potential.

Moreover, discussion on the contribution of directors with corporate governance experience, for instance by Libby (1985), has continued to acknowledge their capability and prospect as valuable human capital to the company. At the same time, people at the corporate ladder need to be motivated and inspired to achieve certain corporate goals, and compensated appropriately to boost their morale and self-actualisation about their responsibilities in the firm (see Donaldson and Davis, 1991; Zajac and Westphal, 1994; Bennis and Thomas, 2002; McGregor, 2002; Sonnenfeld, 2002; Helland and Skyuta, 2005). Potentially, such initiatives may encourage senior independent director to be critical when undertaking his/her audit committee responsibilities.

Besides that, Bhagat and Black (2002) and Yermack (2004) contended, directors' contribution to firm performance would also depend on their extent of understanding of the management, operations and activities of the companies. However, these skills take time to develop and to subsequently influence the directors' board decisions. Respectively, senior independent director's contribution in audit committee's decisions and ultimately firm performance would progress with his/her better understanding of his/her roles, functions and scope of financial reporting and auditing procedures.

(III) The Presence of Financial Experts with Practising Accountant Experience in Audit Committee (ACPI and (ACPACT)

The significance of audit committee members' financial knowledge and skills, in particular accounting practitioners' experience, has been linked with their greater capability to comprehend and perform financial oversight duties effectively, given their relevant working experience [See Libby and Luft, 1993; DeZoort (1997, 1998); McDaniel et al., 2002; Carcello et al., 2006]. With respect to market reaction on companies' appointment of financial expert on their audit committee, Davidson et al., (2004:291) gathered that, investors have greater preference for the presence of individual with auditing and audit experience compared to corporate financial management and financial statement analysis experience.

In addition, Archambeault and DeZoort (2001) contended, a high proportion of independent directors on the audit committee and the presence of committee member(s) with accounting, auditing and/or finance experience will mitigate the incidence of suspicious auditor switching due to company's opinion shopping⁷⁶. Supporting the corresponding studies, OLS 4(i), 4(ii) and 4(iii) results revealed significant positive relationship between the presence of at least one independent director (ACPI) and audit committee member (ACPACT) with practising accountant experience and firm performance (see OLS 4 model results in Tables 8.1 to Table 8.6).

In the case of Malaysia listed firms, the requirement for firms to appoint at least one audit committee member with accounting and finance experience was mandated by MBSB in its 2001

⁷⁶ "...the practice of seeking an auditor willing to support proposed accounting treatment that helps a company achieves its reporting objectives, even though such conduct may impair reliable reporting (US Securities Exchange and Commission in Archambeault and DeZoort, 2001, pg. 34).

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Listing Requirements (see Chapter 15: Para 15.10 and MBSB Practice Note 13/2002: Para 7.0).

Moreover, MCCG (2001) emphasised, the audit committee's financial oversight role is a demanding task that requires commitment, training and skill and understanding of the issues that it deals with on the part of its members in order for them to take an active part in its proceedings.

The implications of audit committee effectiveness has been examined, namely, in terms of the incidence of financial misstatement (Abbott et al., 2004), corporate fraud (Uzun et al., 2004), auditor independence and effectiveness (Carcello and Neal, 2000), and quality of internal control assessment (DeZoort, 1998; Krishnan, 2005). In particular, the committee needs to be diligent in its performance of its financial oversight role of the firm's financial activities and reporting practice to ensure that shareholders' interests are properly protected (see Archambeault and DeZoort, 2001).

Moreover, the scope of audit committee duties and with further assistance from members with accounting, auditing and/or finance experience provides the committee with greater knowledge and awareness⁷⁷ of the state of management's administration of the firm's internal control, reporting practice and financial activities in comparison to other board's members' knowledge on the same subject (see, for instance, the Smith Report, 2003: Para 5.5).

Given the committee's members' exposure to their financial oversight duties and the involvement of its financial expert members in the review of the firm's internal activities and processes, their active participation in the board's evaluation and decision of firm risk policies

⁷⁷ According to MCCG (2001) the formation of an audit committee will allow better allocation of quality time in the assessment of the firm's financial reporting process. In addition, MBSB listing rulings require firms to ensure audit committee has access to firms' resources and information, namely, documents and personnel.

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(see, for instance, Froot et al., 1993) and management's investment planning (see Woolridge and Snow, 1990) will be valuable and significant in ensuring proper management and deployment of the firm's assets and hence safeguarding vested parties' investment.

Further, experience as independent directors on the audit committee of public firms will provide such directors with greater exposure to issues affecting auditor independence and effectiveness, namely, the potential of management to pressure auditors to change their qualified opinions (see Knapp, 1987; DeZoort and Salterio, 2001; Carcello and Neal, 2003). In addition, directors' experience as outside director in several public firms signifies their familiarity and understanding of the demand of their oversight role in the firm as well as their ability to perform the required duties appropriately (Yermack and Shivdasani, 1997). These facts further emphasise the imperativeness for firm to appoint independent financial expert in the audit committee.

Moreover, DeZoort and Salterio (2001) argue that, audit committee members with corporate governance experience will be suitable mediators in the auditor-client disputes, given their experience working with the auditor and knowledge of the scope of their financial oversight duties. They also will be able to acknowledge the auditor's justification for issuing certain audit opinions (see Mutchler, 1985; Groveman, 1995). In addition, audit committee members' corporate governance experience will establish quality independent judgement in audit committee decisions, namely, in resisting managerial attempt to dismiss the auditor for issuing a going concern report (Carcello and Neal, 2003). Particularly, this experience will be useful when the audit committee is required to assess the corporate governance statement of the firm in

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relation to the audit and risk assessment performed by the committee in the firm (see Smith Report, 2003: Para 5.4)

McMullen and Raghunandan (1996) and Carcello and Neal (2003) indicated that the quality of firms' financial reporting practice and internal control evaluation can be enhanced with greater auditor involvement in the firm's corporate governance activities and more effective interaction between auditor and audit committee. In particular DeZoort et al., (1998) and Caplan (1999) contended, the audit committee members' experience in evaluating the firm's internal control system will allow them to contribute productively in discussions with the auditor relating to the amount of audit work that needs to be carried out in the firm and, more importantly, such audit work as is able to uncover errors and fraud practice in the firm. Besides that, audit committee independent members' and primarily the committee's chairman's (see Higgs Report, 2003) direct communication with other board members and involvement in the board decision-making process, establishes them as representative of the auditor on the board (see Kirk and Siegel, 2000).

(IV) The Presence of an Audit Committee Chairman with Practicing Accountant Experience (APACH)

With respect to the impact of an audit committee chairman with practising accountant experience (**APACH**) on firm performance, section 8.2.1 reported an insignificant relationship [See OLS 4(i),(ii) and (iii) model results in Tables 8.1 to 8.6]. Notably, the audit committee chairman has higher authority than other audit committee members. For instance, the Smith Report (2003) identified the role of the audit committee's chairman as including appointing audit committee members, setting the agenda for the committee's meeting(s) and attending the

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company's annual general meeting to clarify matters regarding the audit committee's scope and fulfilment of duties. From observations of the audit committee report of Malaysian listed companies in this study, some firms indicated the audit committee's chairman's authority to include having an additional casting vote in the event of equality of votes in audit committee decisions and presenting the report of the committee's meeting(s) to the firm's board on a regular basis. Also, some companies reported in their corporate governance statement that the audit committee chairman's presence at the annual general meeting is one of the company's initiatives to enhance shareholders' communication with the firm. However, according to Smith Report 2003 (see Para 6.3), communication between the audit committee's chairman and shareholders during the annual meeting is made through the board's chairman.

Given the greater authority and responsibilities of the audit committee's chairman than other audit committee members, his/her practising accountant experience will contribute to the effectiveness of audit committee financial oversight management and implementation, particularly in relation to the evaluation of the firm's reporting and internal control practice (see DeZoort, 1998). The influence of the audit committee chairman and his/her accounting expertise will also facilitate effective communication with the external auditor on matters relating to audit planning, audit tasks and audit findings, and hence the auditor productivity (Boner and Lewis, 1990).

However, the limitation of audit committee executive power and correspondingly of its chairman, may explain the insignificant impact of the audit committee chairman with practising accountant experience in the three audit committee independence observations (i.e. AUDF,

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AUGMJ and AUDMJ) on firm performance. Moreover, at the board level, board members will collectively examine how the quality of the firm's reporting practice, internal control procedures, and potential for corporate fraud will affect investors' perceptions of the firm's corporate governance practice and board accountability. Accordingly, board members' group decision will have greater influence on board decisions than the audit committee chairman's individual judgements.

(V) The Exclusion of Firm's CEO, CFO or Managing Director from Audit Committee Membership (AXCEO)

OLS 4 (ii)(b) and (iii)(b) model results (see Tables 8.3 and 8.5 respectively) revealed a significant negative impact of the non-presence of top executive management (i.e. CEO, CFO or Managing Director) [AXCEO] on firm performance in some of the cases observed. Generally, when top executives are not audit committee members they will be invited to attend the audit committee meeting (see companies Audit Committee Report). In the current study, it was observed that the appointment of CEO, CFO or managing director to the sampled companies' audit committee was undertaken to fulfil the MBSB requirement for financial expert presence on the audit committee and minimum numbers of members on the committee. Further observations on the respective executives backgrounds indicated that, these executives possessed practising accountant experience and hence fulfilled the MBSB financial expert requirement of Para 15.10 (1)(c)(i) and 1(c)(ii).

Specifically, in the case where companies are not able to obtain the service of professional accountant, Para 15.10 1(c)(iii) of Chapter 15 of the MBSB listing rulings and Para 7.1 (b) of the MBSB Practice Note 13/2002 allow the company to fulfil the Exchange requirement with the

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employment of an individual with at least seven years experience as a CFO of a corporation or having a function in the firm with primary responsibilities for the management of the entity's financial affairs. The appointment of individuals with CEO related experience as financial expert on the audit committee was also observed by Carcello et al., (2006). From the managerial skills point of view, the employment of individuals with the management experience of overseeing a firm's financial undertakings will enhance audit committee effectiveness since they are likely to be proactive in the committee's discussions given the importance of communication and management skills in their other job, namely, in their dealings with company personnel, customers, suppliers and financiers (see DeZoort, 1998). Importantly, the MBSB's listing rulings and Practice Note do not specify whether the financial expert has to be someone from outside the firm or an independent director and hence companies may decide to appoint their executive members to the position.

Given the importance of objective and independent evaluation of the firm's financial reporting practice and processes which is mainly prepared by the management, and the importance of financial expert views and judgements on the audit committee on respective matters, the appointment of CEO, CFO or managing director as financial expert may undermine the audit committee's independence, purpose and oversight function. Also, the CEO's influence on the selection process and tenure of board of director members (see Westphal and Zajac, 1995; Shivdasani and Yermack, 1997) may restrict independent members of the audit committee from performing their duties with vigilance and diligence, which are critical to their effectiveness (Verschoor, 1993).

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Moreover, the companies transparency about the appointment of respective top management executive on their audit committee (as disclosed in the companies' Corporate Governance Statement and Audit Committee Report) further informed the investors, regulators and other vested parties of the executives potential impairment on audit committee judgements and accordingly, they would monitor the director's conduct appropriately. In addition, the companies' allocation of funds for audit committee members to obtain independent outside professional advice (see companies' Corporate Governance Statement and Audit Committee Report), allow them to obtain additional financial consultation before making the final decision. Thus, the presence of top management executives in the current study would not be detrimental to audit committee effectiveness due to the establishment of appropriate governing measures to oversee their undue influence on the audit committee decision making.

(VI) The Presence of Family-Member Director on the Audit Committee (ACFAM)

As regards to the impact of the presence of family director on the audit committee (ACFAM) on the firm performance, the results of OLS 4(i), 4(ii) and 4(iii) model [see Tables 8.1 to 8.5 respectively] indicated an insignificant relationship. Namely, there was no statistical evidence to support Jaggi and Leung's (2007) argument that the presence of the firm's controlling interest, notably the family member director, may impose undue pressure on the ability of audit committee independent members to conduct their financial oversight duties objectively and impartially. Further, some companies enclosed an additional stipulation in their audit committee report (i.e. audit committee terms of reference) of the restriction from committee membership of family member(s) and/or relatives of management. In addition, the number of companies which

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appointed family members on their audit committee was small, less than 26% of the total sampled companies (see Chapter 6, Table 6.26).

On the other hand, the appointment of family members or relatives to some companies' audit committee was made in consideration of their financial knowledge and skills. The importance of financial expert judgements on audit committee oversight duties, and hence effectiveness, have been emphasised by many, namely, BRC (1999), DeZoort (2001), Bédard et al., (2004) and Carcello et al., (2006). Even though the independence of audit committee judgements may be affected by the presence of family-member director, the family member's membership of accounting and/or finance professional bodies may influence them to perform their oversight function in the audit committee professionally. Also, the majority presence of independent directors on the audit committee provides further governance of family-member directors' conduct on the committee. Moreover, according to McConaughy et al., (1998), family member motivation to preserve the legacy of the business will ensure his/her monitoring attitude aligns with firm value enhancement. Further, Fama and Jensen (1983) argued that family members' sense of family loyalty can induce them to take action that enhances the firm's business prosperity.

(VII) The Convening of an Audit Committee's Meeting with only the Presence of Independent Members of the Committee and External Auditor (MTEXT)

As reported in section 8.2.1, the convening of a separate meeting between independent members of the audit committee and the external auditor without the presence of executive members (MTEXT) had a significant negative impact on firm performance [See the results of OLS 4(i)(b),

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4(ii)(b) and 4(iii)(b) in Tables 8.2, 8.4 and 8.6 respectively]. The requirement for this separate meeting is stipulated in MBSB listing ruling Para 15.18(f) on the rights of audit committee, and MCCG (2001). Study results indicated that the effectiveness of the collaboration between independent audit committee members and external auditor will depend on the productivity and team working skills of both parties (see DeZoort, 1998; Pye and Pettigrew, 2005). According to Kirk (2000), the close working relationship between independent directors and the external auditor is significant to establish strong corporate governance practice in the firm as well as enhance auditor's accountability and professionalism. Furthermore, effective audit committee and auditor communication and judgements would ensure reliable and credible firm financial reporting practices and hence appropriately safeguarding of shareholders' interests [see MCCG (2001), MBSB listing ruling, Higgs Report (2003) and Smith Report (2003)].

Corporate litigation cases of Enron in USA and its external auditor's firm, Arthur Andersen (see further Powers, 2002) validates the finding of the present study and provide support for the argument presented in the above paragraph. Arthur Andersen was one of the big 5 audit firms and majority of the firms in the current study had employed big 5 audit firms as their external auditor in 2002 and 2003 (see Table 6.43). Considering these circumstances, the extent of investor's trust on external auditor's commitment to co-operate with the independent members of audit committee in assuring the production of true and fair financial reporting may have influenced their low opinions of auditor's credibility and integrity. Even though, there was no significant result found on MTEXT impact on subsequent year performance. Thus, it is imperative for firm to implement responsible governing practices (Parker, 2005) to secure their long term performance.

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(VIII) The Transparency of Audit Committee Authority to Report Firm Violation of Exchange Rules (RBRE)

The MBSB listing ruling in Para 15.17 of Chapter 15 grants an authority to the audit committee to supersede board of director decision by reporting to the Exchange when the board of directors has failed to resolve satisfactorily the issues raised by the committee, which has resulted in the firm's breaching of the MBSB rules. OLS 4(i), 4(ii) and 4(iii) model results [see Tables 8.1 to 8.6 respectively] indicated that when firms disclosed the audit committee's authority to report its violation of Exchange ruling to the Exchange there was a significant positive impact on firm performance in all three categories of audit committee independence examined ($p = 0.1$). The importance of such authority to the audit committee has been noted by the Smith Report (2003: Para 4.4). In particular, it proposed that the audit committee be given the right to report to shareholders about board failure to resolve appropriately the issues raised by the audit committee as part of director's report.

The link between audit committee independence and incidence of financial reporting and regulatory fraud has been examined by Uzun et al., (2004). Their findings indicated that the audit committee's formation and independence were important elements of the firm's governing mechanisms against corporate fraud.

(X) The Attendance Rate of Audit Committee Member in the Meeting(s) [NATEND]

OLS 4(i)(a) model result [see Table 8.1] revealed a significant negative relationship between the average rate of audit committee members' attendance at the committee's meeting in 2002 [NATEND] and firm performance in 2003 ($p = 0.1$). According to PwC (2003), the attendance

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of audit committee members at the committee's meetings is one of the indicators of their commitment to dedicate a significant amount of time and effort to the committee's activities.

In Chapter 6 (see Table 6.48), the descriptive statistics for audit members attendance rate at meetings revealed an improvement in their attendance rate in 2003. It is imperative for each audit committee member to actively participate in the committee's discussions (Bédard et al., 2004), as the more quality information that can be gathered from members, the greater the ability of the committee to make effective informed decision-making (see PwC, 2003). In this study, the lack of effectiveness of audit committee members' performance of duties might explain the significant negative association between their attendance rate and firm performance.

Further examination of the sampled companies' audit committee activities from their audit committee report showed, many of them had convened at least four meetings in a year or every quarter in preparation of the firm's interim financial report. The specific purpose of the meeting and the MBSB requirement for the production of an interim report may have influenced committee members' effectiveness. Moreover, members' familiarity with the procedures and clear regulatory guidance on the information to be disseminated for public usage may have contributed to the effective implementation of their oversight duties. PwC (2003) noted in many European companies that their audit committee was convened on average three to four times in a year. PwC discerned that, in order for audit committee meetings to produce targeted results, audit committee members (as well as being independent of management and having financial expertise) needed to conduct such meetings at a relevant time, and the agendas of the meetings needed to be well-prepared to ensure that important and material oversight issues and procedures

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were appropriately examined at that time. Moreover, PwC indicated that audit committee effectiveness is enhanced when the number of meetings and the length of time spent in such meetings contribute to the effective accomplishment of meetings' stated objective.

According to the Smith Report (2003), the effectiveness of audit committee members will depend on the willingness of members to commit sufficient time and effort to the performance of their oversight duties. In the case of the current study, the time constraint on audit committee members due to their directorships in other companies may have affected their commitment to perform audit committee activities (see Morck et al., 1988; PwC, 2003), and prevented them from fully utilising the quarterly meetings to underlying issues pertaining to their oversight of the procedures and preparation of the firm's annual report with auditors and management. The absence of some of the committee members, particularly those with financial expertise may have affected the productivity of audit committee as a whole and hence their decisions.

In light of the shareholders' greater need for transparency of and quality financial reporting information, Verschoor et al., (2002) contended that the frequency of audit committee meetings indicates the committee's commitment to undertake its oversight duties seriously since the allocation of substantial time to gather sufficient information will ensure better informed judgement about the firm's business, risks and control circumstances. Further, according to McMullen and Raghunandan (1996), regular audit committee meetings will ensure the financial reporting process is functioning properly and enable committee members to keep abreast of accounting and internal control related issues.

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Moreover, an effective audit committee will convene a meeting before the board of directors' meeting to ensure the important issues that the committee wants to raise at board discussions are properly presented to facilitate appropriate evaluation of such issues by board members. Also, an effective audit committee will undertake in-depth discussions with management, external auditors and internal auditors regarding the firm's financial reporting and internal control procedures. However, meeting frequency may not reflect the effectiveness of audit committee members if they do not participate actively in discussions with management and auditors (Gendron et al., 2004). Audit committee members' vigilant attitudes will ensure transparency, integrity and accountability in the firm's activities, proper monitoring of the firm's assets' deployment, and supply of quality information by management, hence safeguard the rights and interests of shareholders (Ezammel and Watson, 1997; Kirk, 2000; Turley and Zaman, 2004).

(XI) The Proportion of Family Directors with Accounting and Finance Skills (NFACF)

OLS 4(i)(a) result also revealed a significant negative relationship ($p = 0.05$) between the proportion of family directors with accounting and finance skills (NFACF) and firm performance. This result supported Johnson et al., (2000) argument that executive directors who are family members may act in the best interest of their family rather than shareholders interests as a whole. Furthermore, family-owned and controlled firms have been found to dominate the internal political processes of large corporations in the case of managerial succession plans (Allen and Panian, 1982). Specifically, the CEO who is related to family members on the board of directors and also owns shares in the firm has immunity or can demand longer tenure than a non-family related CEO would be able to do. For instance, Boeker (1992) found family-related CEOs who retained their posts, tended to place the blame on the top managers when the firm

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performed poorly, despite the key role that he/she played in making the business decisions. Similarly, Volpin (2002) in his study on executive turnover in Italy, observed that companies were more likely to replace non-family managers than family managers when facing financial difficulties.

On the other hand, family-member directors' financial background may assist the board in its performance of risk assessment and investment planning (see Westphal and Zajac, 1995; Lee et. al., 1999; Kale et. al., 2003; Guner et. al. 2004). Further, given family-member directors' direct management of the firm's operation, their financial knowledge and skills could have been acquired to meet the lack in specific financial expertise such as risk, investment and financial management. Moreover, family-member directors' involvement in the day- to- day operations of the business provides them with the opportunity to develop their financial skills and experience, in line with demands from the family business for their expertise (see Pye and Pettigrew, 2005).

8.2.2 *Audit Committee Leadership and Firm Performance – OLS 5*

Chapter 5, section 5.2.1.2 indicated that, the impact of audit committee leadership on firm performance was examined by research models OLS 5(i), OLS 5(ii), OLS 5(iii), OLS 5(iv) and OLS 5(v). Specifically, each model examined the chairing of the audit committee by a senior independent director (ACHSIN), independent director with an accounting and finance background (ACHACF), independent director with a business and/or management related background (ACBUS), independent director with practising accountant experience (AHP), and senior independent director with practising accountant experience (ACHSINP). The following subsections will respectively discuss the five OLS 5 models.

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(I) Senior Independent Director Appointment as Audit Committee's Chairman (ACHSIN) and Firm Performance – OLS 5(i)

Tables 8.8 and 8.9 respectively present the regression results for model OLS 5(i)(a) [i.e. regression of ACHSIN and specified audit committee leadership variables in 2002 with respective firm performance 2002 and 2003] and model OLS 5(i)(b) [i.e. regression of ACHSIN and specified audit committee leadership variables in 2003 with respective firm performance 2003 and 2004].

In section 5.2.1.2 of Chapter 5, HACL 1 hypothesised that the appointment of a senior independent director as audit committee chairman (ACHSIN) will have a positive impact on firm performance. OLS 5(i)(a) model results pointed to the contrary since there was a significant negative relationship between ACHSIN in 2002 and NTobin's Q in 2002 ($\beta = -0.31$; $p = 0.05$).

Table 8.8 : Audit Committee Leadership and Firm Performance -- OLS 5(i)(a)
The Appointment of Senior Independent Director as Audit Committee Chairman (ACHSIN) in 2002 and Firm Performance 2002 and 2003
(The Testing of HAC1 1)

AC = Audit Committee, INED = Independent director, ACHSIN = AC chairman is senior independent director, NASET = Total assets, NDEQ = Debt to equity ratio, ACFAM = Presence of family member director on AC, NFAMDI = Proportion of family-member directors, Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, MAINB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index: less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (dv); Statistical significance level: 0.1 (), 0.05 (**), 0.01 (***) ; All t-statistical values are significant at the 0.001 level]*

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2491		0.1374		0.2364		0.1234	
R ²	0.3174		0.2158		0.3058		0.2031	
F	4.6499		2.7521		4.4047		2.5484	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.1510	-0.7049	-0.1276	-0.5557	-0.3120	-1.4439	-0.0320	-0.1382
<i>Explanatory Variables (β)</i>								
ACHSIN02	-0.3148	-2.4200**	0.1312	0.9409	-0.1747	-1.3312	0.1409	1.0026
<i>Control Variables</i>								
NASET02	-0.3163	-3.6656***	0.3908	4.2250***	-0.2819	-3.2398***	0.3637	3.9007***
NDEQ02	0.1938	2.7911***			0.3432	4.9002***		
ACFAM02					0.3796	2.1006**		
NFAMDI02	-0.2088	-2.0954**			-0.1843	-1.8340*		
NINSTL02					0.1986	2.0092*		
<i>Industry Dummy</i>								
MAINB					0.2994	1.6753*		
PROP	-0.9124	-4.0621***			-0.8182	-3.6119***		
CONSTR	0.4664	1.8804*			0.5502	2.1995**		
FIN					-0.5290	-2.0709**		

Table 8.9 : Audit Committee Leadership and Firm Performance -- OLS 5(i)(b)
The Appointment of Senior Independent Director as Audit Committee Chairman (ACHSIN) in 2003 and Firm Performance 2003 and 2004
(The Testing of HAC1)

AC = Audit Committee, ACHSIN = AC chairman is senior independent director, NASET = Total assets, NDEQ = Debt to equity ratio, NINED = Proportion of independent directors on the Board, CHIN = Board's chairman is independent director, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, PROP = Property industry, CONSTR = Construction industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All V-statistical values are significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2520		0.1789		0.0634		0.1232	
R ²	0.3200		0.2535		0.1505		0.2048	
F	4.7053		3.3959		1.7278		2.5109	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.3317	-1.5406	0.0453	0.2006	-0.1981	-0.8130	-0.2940	-1.2482
<i>Explanatory Variables (β)</i>								
ACHSIN03	-0.0719	-0.5455	0.2004	1.4509	-0.0750	-0.5024	0.0517	0.3584
<i>Control Variables</i>								
NASET03	-0.3239	-3.6800***	0.4663	5.0564***	-0.1850	-1.8570*	0.2412	2.5047**
NDEQ03	0.3451	5.0202***					0.1608	2.1388**
NINED03			-0.1839	-2.6061***				
CHIN03							0.3304	2.0483**
NINSTL03	0.2861	2.8505***					0.1752	1.7521*
AUF503	0.2583	1.8428***			0.3235	2.0399**	0.2441	2.2228**
<i>Industry Dummy</i>								
PROP	-0.7370	-3.3314***			-0.5029	-2.0088**		
CONSTR	0.4082	1.6577*						

(II) Audit Committee Chairman with Accounting and Finance Background (ACHACF) and Firm Performance
- OLS 5(ii)

Tables 8.10 and 8.11 respectively present the regression results for model OLS 5(ii)(a) [i.e. regression of ACHACF and specified audit committee leadership variables in 2002 with respective firm performance 2002 and 2003] and model OLS 5(ii)(b) [i.e. regression of ACHACF and specified audit committee leadership variables in 2003 with respective firm performance 2003 and 2004].

Namely, HACL 2 predicted that the appointment of audit committee chairman with accounting and financial background (ACHACF) will have a positive impact on firm performance. OLS 5(ii)(a) model results revealed a significant positive relationship between ACHACF in 2002 and NTobin's Q in 2003 ($\beta = 0.29$; $p = 0.05$).

Table 8.10 : Audit Committee Leadership and Firm Performance -- OLS 5(ii)(a)

**The Appointment of Audit Committee's Chairman with Accounting and Finance Background (ACHACF) in 2002 and Firm Performance 2002 and 2003
(The Testing of HACL 2)**

AC = Audit Committee, ACHACF = AC chairman possesses accounting and finance background, NASET = Total assets, NDEQ = Debt to equity ratio, ACFAM = Presence of family member director on AC, NFAMD1 = Proportion of family-member directors, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All t-statistical values are significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2353		0.1337		0.2494		0.1192	
R ²	0.3048		0.2125		0.3176		0.1993	
F	4.3846		2.6979		4.6545		2.4893	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.3520	-1.6021	-0.0692	-0.2958	-0.5129	-2.3559**	0.0023	0.0095
<i>Explanatory Variables (β)</i>								
ACHACF02	0.1831	1.4589	-0.0241	-0.1808	0.2854	2.2961**	0.0327	0.2428
<i>Control Variables</i>								
NASET02	-0.3230	-3.7071***	0.3971	4.2821***	-0.2731	-3.1630***	0.3745	4.0052***
NDEQ02	0.2127	3.0482***			0.3562	5.1529***		
ACFAM02					0.3985	2.2349**		
NFAMD102	-0.2410	-2.4092**			-0.2074	-2.0932**		
NINSTL02					0.2054	2.1033**		
<i>Industry Dummy</i>								
PROP	-0.9293	-4.1021***			-0.8117	-3.6166***		
CONSTR	0.5098	2.0228**			0.6175	2.4726**		
FIN					-0.5023	-1.9839**		

Table 8.11: Audit Committee Leadership and Firm Performance -- OLS 5(ii)(b)
The Appointment of Audit Committees Chairman with Accounting and Finance Background (ACHACF) in 2003 and Firm Performance 2003 and 2004
(The Testing of HACL 2)

AC = Audit Committee, ACHACF = AC chairman possesses accounting and finance background, NASET = Total assets, NDEQ = Debt to equity ratio, CHIN = Board's chairman is independent director, NINDPV = Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, PROP = Property industry, CONSTR = Construction industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***); All V-statistical values are significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
Adj R ²	0.2525		0.1810		0.0622		0.1346	
R ²	0.3204		0.2554		0.1494		0.2151	
F	4.7155		3.4303		1.7130		2.6726	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.3071	-1.3739	-0.3071	-1.3739	-0.2294	-0.9059	-0.1351	-0.5558
<i>Explanatory Variables (β)</i>								
ACHACF03	-0.0827	-0.6615	-0.3071	-1.3739	0.0050	0.0352	-0.2234	-1.6436
<i>Control Variables</i>								
NASET03	-0.3253	-3.7025***	-0.3253	-3.7025***	-0.1880	-1.8886*	0.2470	2.5850**
NDEQ03	0.3419	4.9695***	0.3419	4.9695***			0.1547	2.0682**
CHIN03							0.3248	2.0514**
NINDPV03							0.1754	1.7655*
NINSTL03	0.2920	2.8958***	0.2920	2.8958***			0.2628	2.3965**
AUF503	0.2561	1.8272*	0.2561	1.8272*	0.3254	2.0491**		
<i>Industry Dummy</i>								
PROP	-0.7566	-3.3887	-0.7566	-3.3887***	-0.5009	-1.9809**		
CONSTR	0.4248	1.7311	0.4248	1.7311*				

(III) Audit Committee Chairman with Business and Management Related Background (ACHBUS) and Firm Performance – OLS 5(iii)

Tables 8.12 and 8.13 respectively present the regression results for model OLS 5(iii)(a) [i.e. regression of ACHBUS and specified audit committee leadership variables in 2002 with respective firm performance 2002 and 2003] and model OLS 5(iii)(b) [i.e. regression of ACHBUS and specified audit committee leadership variables in 2003 with respective firm performance 2003 and 2004].

HACL 3 hypothesised that the appointment of an audit committee chairman with a business and/or management related background (ACHBUS) will have an impact on firm performance. OLS 5(iii)(a) model results pointed to a significant negative relationship between ACHBUS in 2002 and NTobin's Q in 2002 ($\beta = - 0.30$; $p = 0.1$).

Table 8.12 : Audit Committee Leadership and Firm Performance -- OLS 5(iii)(a)

**The Appointment of Audit Committee Chairman with Business and Management Related Background (ACHBUS) in 2002 and Firm Performance 2002 and 2003
(The Testing of HACL 3)**

AC = Audit Committee, ACHBUS = AC chairman possess business/management related background, NASET = Total assets, NDEQ = Debt to equity ratio, ACFAM = Presence of family member director on AC, NFAMDI = Proportion of family-member directors, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, MAINB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) All t-statistical values are significant at the 0.001 level]

Performance Measure	NTOBIN'S Q 2002		NROE 2002		NTOBIN'S Q 2003		NROE 2003	
Adj R ²	0.2392		0.1345		0.2350		0.1199	
R ²	0.3084		0.2132		0.3046		0.1999	
F	4.4585		2.7092		4.3799		2.4987	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.2192	-1.0342	-0.0689	-0.3046	-0.3446	-1.6214	0.0302	0.1327
<i>Explanatory Variables (β)</i>								
ACHBUS02	-0.2987	-1.7798*	-0.0822	-0.4593	-0.2009	-1.1937	-0.0825	-0.4571
<i>Control Variables</i>								
NASET02	-0.3193	-3.6708***	0.4033	4.3473***	-0.2816	-3.2296***	0.3768	4.0282***
NDEQ02	0.2065	2.9669***			0.3498	5.0118***		
ACFAM02					0.4011	2.2285**		
NFAMDI02	-0.2481	-2.4821**			-0.2075	-2.0711**		
NINSTL02					0.2170	2.1958**		
<i>Industry Dummy</i>								
MAINB					0.3004	1.6793*		
PROP	-0.9350	-4.1417***			-0.8296	-3.6644***		
CONSTR	0.4727	1.8930**			0.5544	2.2141**		
FIN					-0.5465	-2.1294**		

Table 8.13: Audit Committee Leadership and Firm Performance -- OLS 5(iii)(b)

**The Appointment of Audit Committee Chairman with Business and Management Related Background (ACHBUS) in 2003 and Firm Performance 2003 and 2004
(The Testing of HACL 3)**

AC = Audit Committee, ACHBUS = AC chairman possess business/management related background, NASET = Total assets, NDEQ = Debt to equity ratio, NINED = Proportion of independent directors on the Board, CHIN = Board's chairman is independent director, NINDPV = Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, PROP = Property industry, CONSTR = Construction industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d_U); Statistical significance level: 0.1 (*), 0.05 (**), 0.01 (***) ; All t -statistical values are significant at the 0.05 level]

Performance Measure	NTOBIN'S Q 2003		NROE 2003		NTOBIN'S Q 2004		NROE 2004	
<i>Adj R²</i>	0.2548		0.1702		0.0638		0.1227	
<i>R²</i>	0.3226		0.2457		0.1509		0.2043	
<i>F</i>	4.7616		3.2566		1.7326		2.5032	
	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>	<u>Coefficient</u>	<u>t-stat</u>
Intercept (α)	-0.3816	-1.8145	0.1192	0.5374	-0.2408	-1.0101	-0.2764	-1.1989
<i>Explanatory Variables (β)</i>								
ACHBUS03	0.1710	1.0318	0.0102	0.0583	0.1087	0.5784	0.0140	0.0772
<i>Control Variables</i>								
NASET03	-0.3213	-3.6564***	0.4745	5.1171***	-0.1844	-1.8517*	0.2437	2.5292**
NDEQ03	0.3396	4.9396***					0.1610	2.1353**
NINED03			-0.1766	-2.4967**				
CHIN03							0.3212	2.0149**
NINDPV03							0.1762	1.7611*
NINSTL03	0.3022	2.9771***					0.2461	2.2110**
AUF503	0.2480	1.7672*			0.3176	1.9969**		
<i>Industry Dummy</i>								
PROP	-0.7534	-3.4026***			-0.5130	-2.0440**		
CONSTR	0.4652	1.8694*						

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**(IV) Audit Committee Chairman with Practicing Accountant Experience (ACHP) and Firm Performance  
- OLS 5(iv)**

Tables 8.14 and 8.15 respectively present the regression results for model OLS 5(iv)(a) [i.e. regression of ACHP and specified audit committee leadership variables in 2002 with respective firm performance 2002 and 2003] and model OLS 5(iv)(b) [i.e. regression of ACHP and specified audit committee leadership variables in 2003 with respective firm performance 2003 and 2004].

Specifically, HACL 4 predicted that the appointment of an audit committee chairman with a practising accountant background (ACHP) will have a positive impact on firm performance. The results of OLS 5(iv)(a) and OLS 5(iv)(b) models pointed to the contrary. The relationship between ACHP and firm performance was not statistically significant, both in terms of the market value (NTobin's Q) and accounting-based measure (NROE) of performance.

**Table 8.14 : Audit Committee Leadership and Firm Performance --- OLS 5(iv)(a)**

**The Appointment of Audit Committee Chairman with Practising Accountant Experience (ACHP) in 2002 and Firm Performance 2002 and 2003**

**(The Testing of HACL 4)**

AC = Audit Committee, ACHP = AC chairman possess practising accountant experience, NASET = Total assets, NDEQ = Debt to equity ratio, ACFAM = Presence of family member director on AC, NFAMDI = Proportion of family-member directors, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, MAINB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>u</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values are significant at the 0.001 level]

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |               | NTOBIN'S Q 2003    |               | NROE 2003          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| <i>Adj R<sup>2</sup></i>         | 0.2283             |               | 0.1441             |               | 0.2369             |               | 0.1228             |               |
| <i>R<sup>2</sup></i>             | 0.2984             |               | 0.2219             |               | 0.3063             |               | 0.2026             |               |
| <i>F</i>                         | 4.2538             |               | 2.8525             |               | 4.4155             |               | 2.5403             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | -0.2891            | -1.3291       | -0.1608            | -0.7022       | -0.4407            | -2.0378**     | -0.0300            | -0.1296       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>ACHP02</b>                    | 0.0792             | 0.5392        | 0.2430             | 1.5711        | 0.2026             | 1.3868        | 0.1466             | 0.9359        |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET02</b>                   | -0.3355            | -3.8518***    | 0.3989             | 4.3485***     | -0.2925            | -3.3771***    | 0.3724             | 4.0097***     |
| <b>NDEQ02</b>                    | 0.2141             | 3.0386***     |                    |               | 0.3623             | 5.1717***     |                    |               |
| <b>ACFAM02</b>                   |                    |               |                    |               | 0.3780             | 2.0915**      |                    |               |
| <b>NFAMDI02</b>                  | -0.2379            | -2.3674**     |                    |               | -0.2048            | -2.0499**     |                    |               |
| <b>NINSTL02</b>                  |                    |               |                    |               | 0.2024             | 2.0526**      |                    |               |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.9410            | -4.1373***    |                    |               | 0.3113             | 1.7402*       |                    |               |
| <b>CONSTR</b>                    | 0.4677             | 1.8599*       |                    |               | -0.8260            | -3.6522***    |                    |               |
| <b>FIN</b>                       |                    |               |                    |               | 0.5526             | 2.2098**      |                    |               |
|                                  |                    |               |                    |               | -0.4982            | -1.9490*      |                    |               |

**Table 8.15: Audit Committee Leadership and Firm Performance -- OLS 5(iv)(b)**  
**The Appointment of Audit Committee Chairman with Practising Accountant Experience (AHP) in 2003 and Firm Performance 2003 and 2004**  
**(The Testing of HACL 4)**

AC = Audit Committee, AHP = AC chairman possess practising accountant experience, NASET = Total assets, NDEQ = Debt to equity ratio, NINED = Proportion of independent directors on the board, CHIN = Board's chairman is independent director, INDPV = Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, PROP = Property industry, CONSTR = Construction industry, 03 = Year 2003, 04 = Year 2004. A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>u</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All V<sup>2</sup>-statistical values are significant at the 0.05 level]

| Performance Measure              | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2518             |               | 0.1703             |               | 0.0721             |               | 0.1233             |               |
| R <sup>2</sup>                   | 0.3198             |               | 0.2457             |               | 0.1584             |               | 0.2049             |               |
| F                                | 4.7022             |               | 3.2570             |               | 1.8354             |               | 2.5122             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | -0.3905            | -1.7852*      | 0.1139             | 0.4943        | -0.3282            | -1.3324       | -0.2480            | -1.0367       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>AHP03</b>                     | 0.0738             | 0.5059        | 0.0157             | 0.1020        | 0.2373             | 1.4434        | -0.0617            | -0.3866       |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET03</b>                   | -0.3321            | -3.7515***    | 0.4730             | 5.0733***     | -0.2052            | -2.0585**     | 0.2477             | 2.5582**      |
| <b>NDEQ03</b>                    | 0.3473             | 5.0349***     |                    |               |                    |               | 0.1589             | 2.1067**      |
| <b>NINED03</b>                   |                    |               | -0.1771            | -2.4986**     |                    |               |                    |               |
| <b>CHIN03</b>                    |                    |               |                    |               |                    |               | 0.3165             | 1.9799**      |
| <b>NINDPV03</b>                  |                    |               |                    |               |                    |               | 0.1815             | 1.7971*       |
| <b>NINSTL03</b>                  | 0.2835             | 2.8224***     |                    |               |                    |               | 0.2462             | 2.2410**      |
| <b>AUF503</b>                    | 0.2629             | 1.8742*       |                    |               | 0.3349             | 2.1202**      |                    |               |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.7324            | -3.3079***    |                    |               | -0.4894            | -1.9630       |                    |               |
| <b>CONSTR</b>                    | 0.4295             | 1.7449*       |                    |               |                    |               |                    |               |

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(V) Audit Committee Senior Independent Chairman with Practicing Accountant Experience (ACHSINP) and Firm Performance – OLS 5(v)

Tables 8.16 and 8.17 respectively presents the regression results for model OLS 5(v)(a) [i.e. regression of ACHSINP and specified audit committee leadership variables in 2002 with respective firm performance 2002 and 2003] and model OLS 5(v)(b) [i.e. regression of specified ACHSINP and audit committee leadership variables in 2003 with respective firm performance 2003 and 2004].

Hypothesis HACL 5 posited that the appointment of a senior independent director with practising accountant experience (ACHSINP) as audit committee chairman will have a positive impact on firm performance. OLS 5(v)(a) model results pointed to the contrary since there existed a significant negative relationship between ACHSINP in 2002 and NTobin's Q in 2002 ( $\beta = -0.47$ ;  $p = 0.05$ ).

**Table 8.16 : Audit Committee Leadership and Firm Performance -- OLS 5(v)(a)**

**The Appointment of Senior Independent Audit Committee's Chairman with Practicing Accountant Experience (ACHSINP) in 2002 and Firm Performance 2002 and 2003  
(The Testing of HACL 5)**

AC = Audit Committee, ACHSINP = Senior independent director AC chairman possesses practising accountant experience, NASET = Total assets, NDEQ = Debt to equity ratio, ACFAM = Presence of family member director on AC, NFAMDI = Proportion of family-member directors, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, MAINB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All t-statistical values are significant at the 0.001 level]

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |               | NTOBIN'S Q 2003    |               | NROE 2003          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2456             |               | 0.1397             |               | 0.2315             |               | 0.1254             |               |
| R <sup>2</sup>                   | 0.3142             |               | 0.2179             |               | 0.3014             |               | 0.2049             |               |
| F                                | 4.5819             |               | 2.7860             |               | 4.3143             |               | 2.5770             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | -0.2253            | -1.0713       | -0.1026            | -0.4566       | -0.3619            | -1.7045*      | -0.0040            | -0.0177       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>ACHSINP02</b>                 | -0.4639            | -2.2139**     | 0.2666             | 1.1916        | -0.1505            | -0.7115       | 0.2730             | 1.2099        |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET02</b>                   | -0.3389            | -3.9344***    | 0.4007             | 4.3562***     | -0.2937            | -3.3782***    | 0.3743             | 4.0353***     |
| <b>NDEQ02</b>                    | 0.2058             | 2.9693***     |                    |               | 0.3509             | 5.0152***     |                    |               |
| <b>ACFAM02</b>                   |                    |               |                    |               | 0.4002             | 2.2174**      |                    |               |
| <b>NFAMDI02</b>                  | -0.2121            | -2.1241**     |                    |               | -0.1916            | -1.9010*      |                    |               |
| <b>NINSTL02</b>                  |                    |               |                    |               | 0.2096             | 2.1207**      |                    |               |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.9688            | -4.3058***    |                    |               | 0.3077             | 1.7120*       |                    |               |
| <b>CONSTR</b>                    | 0.4497             | 1.8078*       |                    |               | -0.8440            | -3.7164***    |                    |               |
| <b>FIN</b>                       |                    |               |                    |               | 0.5449             | 2.1704**      |                    |               |
|                                  |                    |               |                    |               | -0.5304            | -2.0661**     |                    |               |

**Table 8.17: Audit Committee Leadership and Firm Performance -- OLS 5(v)(b)**

**The Appointment of Senior Independent Audit Committee's Chairman with Practicing Accountant Experience (ACHSINP) in 2003 and Firm Performance 2003 and 2004  
(The Testing of HACL 5)**

AC = Audit Committee, ACHSINP = Senior independent director AC chairman possesses practising accountant experience, NASET = Total assets, NDEQ = Debt to equity ratio, NINED = Proportion of independent directors on the Board, CHIN = Board's chairman is independent director, INDPV= Total Proportion of Individuals' and/or Private Companies' Substantial Equity Holdings, NINSTL = Total proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>u</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*); All F-statistical values are significant at the 0.05 level]

| Performance Measure              | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2509             |               | 0.1807             |               | 0.0625             |               | 0.1302             |               |
| R <sup>2</sup>                   | 0.3190             |               | 0.2552             |               | 0.1497             |               | 0.2111             |               |
| F                                | 4.6834             |               | 3.4258             |               | 1.7170             |               | 2.6097             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | -0.3593            | -1.7025       | 0.1604             | 0.7269        | -0.2192            | -0.9182       | -0.2407            | -1.0478       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>ACHSINP03</b>                 | 0.0050             | 0.0223        | -0.3768            | -1.5989       | -0.0668            | -0.2622       | -0.3199            | -1.3041       |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET03</b>                   | -0.3269            | -3.7090***    | 0.4836             | 5.2479***     | -0.1862            | -1.8677*      | 0.2513             | 2.6189***     |
| <b>NDEQ03</b>                    | 0.3443             | 5.0031***     |                    |               |                    |               | 0.1648             | 2.1998**      |
| <b>NINED03</b>                   |                    |               | -0.1656            | -2.3444**     |                    |               |                    |               |
| <b>CHIN03</b>                    |                    |               |                    |               |                    |               | 0.2981             | 1.8664*       |
| <b>NINDPV03</b>                  |                    |               |                    |               |                    |               | 0.1961             | 1.9457*       |
| <b>NINSTL03</b>                  | 0.2852             | 2.8311***     |                    |               |                    |               | 0.2554             | 2.3285**      |
| <b>AUF503</b>                    | 0.2597             | 1.8492*       |                    |               | 0.3274             | 2.0608**      |                    |               |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.7362            | -3.3238***    |                    |               | -0.5040            | -2.0116**     |                    |               |
| <b>CONSTR</b>                    | 0.4203             | 1.7026*       |                    |               |                    |               |                    |               |

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Table 8.18 summarises findings for the impact of audit committee leadership on firm performance.

**Table 8.18: Summary of Findings for the Impact of Audit Committee Leadership on Firm Performance**

| <i>Audit Committee Board Leadership and Firm Performance ---OLS 5</i>                        |                                 |                       |
|----------------------------------------------------------------------------------------------|---------------------------------|-----------------------|
| Hypothesis HA CL                                                                             | Postulated Relationship (+/-/?) | Results               |
| HA CL 1: <i>Chairing of AC by SRINED [ACHSIN]</i>                                            | +                               | Not Supported         |
| HA CL 2: <i>Chairing of AC by INED with ACF background [ACACF]</i>                           | +                               | Supported             |
| HA CL 3: <i>Chairing of AC by INED with business/ management related background [ACHBUS]</i> | ?                               | Negative Relationship |
| HA CL 4: <i>Chairing of AC by INED with PAE [ACHP]</i>                                       | +                               | Not Supported         |
| HA CL 5: <i>Chairing of AC by SRINED with PAE [ACHSINP]</i>                                  | +                               | Not Supported         |

*Notes: AC = Audit Committee; INED = Independent Director; SRINED = Senior Independent Director; ACF = Accounting and Finance; PAE = Practising Accountant Experience*

**8.2.2.1 Discussions of the Impact of Audit Committee Leadership on Firm Performance --- OLS 5(i), OLS 5(ii), OLS 5(iii), OLS 5(iv) and OLS 5(v) Results**

Notably, the chairman of the audit committee assumes greater responsibilities than other audit committee members and hence needs to allocate a significant amount of time to leading and ensuring the effectiveness of the committee (Smith Report, 2003). The chairman's duties include setting up audit committee meetings and meeting agendas, appointing audit committee members, establishing regular contact with the firm's board of directors (particularly the board's chairman), CEO, finance director, audit lead partner and chief internal auditor (see MCGG, 2001; Higgs Report, 2003; Smith Report, 2003)

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Findings for the impact of audit committee leadership on firm performance indicated that, an audit committee chairman with an accounting and finance background (**ACHACF**) will contribute to the enhancement of firm performance. This result further established the significance of accounting and finance related experience in ensuring the effectiveness of audit committee management. OLS 5 results, however, revealed an insignificant impact of an audit committee chairman with practising accountant (**ACHP**) on firm performance and a significant negative relationship between the chairing of the audit committee by a senior independent director (**ACHSIN**), senior independent director with practising accountant experience (**ACHSINP**) and an independent director with a business and/or management background (**ACHBUS**). According to Wofford and Liska (1993), leaders' behaviours psychologically have a psychological impact on the motivation of subordinates to accomplish targeted outcomes. Stinson and Johnson (1975) found that, the audit committee chairman's less directive behaviour and awareness of external auditors' statutory auditing duties will enhance the auditor's morale to work productively.

Potentially, the audit committee chairman's communication and management skills can have an impact on his/her abilities to direct audit committee members and interact effectively with the firm's board chairman, audit lead partner, chief internal auditor and CEO. The chairman's direct dealings with these people has been noted by the Smith Report (2003) as part of his/her crucial function to establish effective relationships and cooperation between the committee and the board, top management, executive members and external auditor for better audit committee performance. Moreover, audit committee members and external auditors require access to the firm's internal information and resources to perform their oversight responsibilities



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appropriately. The cooperation and accountability of members of management are crucial in the supply of quality information to audit committee members and the auditor (see Ezammel and Watson, 1997). In this case, the audit committee's chairman's influence and reputation will facilitate the acquirement of necessary resources from management, particularly when the two parties have a mutual understanding and good relationship (see Westphal, 1999). Further, according to Wofford and Liska (1993), a leader's supportive and co-operative behaviours are crucial in an environment where subordinates' performance of duties are restricted by the availability of and access to information due to the control of the resources by other entities.

### 8.2.3 *Audit Committee Competency and Firm Performance – OLS 6*

The impact of audit committee competency on firm performance was examined by the research model OLS 6. The research model investigated the relationship between the proportion of audit committee members with accounting and/or finance knowledge and skills (NAUACF), practising accountant experience (NAPACT), business and management knowledge and skills (NACBUS), law qualification (NACLAW), and company secretary experience (NACSEC) on firm performance.

Tables 8.19 and 8.20 respectively presents the regression results for model OLS 6(a) [i.e. regression of specified audit committee competency variables in 2002 with respective firm performance 2002 and 2003] and model OLS 5(v)(b) [i.e. regression of specified audit committee competency variables in 2003 with respective firm performance 2003 and 2004].

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HACKNOW 2 proposed that the proportion of audit committee members with practising accountant experience (NAPACT) will have a positive impact on firm performance. On the other hand OLS 6(a) and 6(b) reported mixed findings for the relationship between NAPACT and firm performance. Specifically, OLS 6(a) indicated a significant negative relationship between NAPACT in 2002 and NTobin's Q in 2003 ( $\beta = -0.15$ ;  $p = 0.1$ ). Whilst, OLS 6(b) result revealed a significant positive relationship between NAPACT in 2003 and NROE in 2004 ( $\beta = 0.18$ ;  $p = 0.05$ ).

With respect to testing of HACKNOW 4, OLS 6(b) model result revealed a significant positive relationship between the proportion of audit committee members with a law background (NACLAW) in 2003 and NROE in 2004 ( $\beta = 0.15$ ;  $p = 0.1$ ).

On the other hand, OLS 6(a) and OLS 6(b) model results were not statistically significant to support hypotheses HACKNOW 1 [the proportion of audit committee members with accounting and finance background (NAUACF)], HACKNOW 3 [the proportion of audit committee members with business and/or management experience (NACBUS)] and HACKNOW 5 [the proportion of audit committee members with company secretary experience (NACSEC)].

**Table 8.19 : Audit Committee Competency and Firm Performance -- OLS 6(a)**  
**The Examination of Audit Committee Competency in 2002 and Firm Performance in 2002 and 2003**  
**(The Testing of HACKNOW 1, 2, 3, 4, and 5)**

AC = Audit Committee, NAUACF = Proportion of AC members with accounting and finance background, NAPACT = Proportion of AC members with practising accountant experience, NACBUS = Proportion of AC members with business/management related background, NACLAW = Proportion of audit committee members with a law background, NACSEC = Proportion of AC members with company secretary experience, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of family-member directors, NBDSZ = Size of Board of directors, PROP = Property industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All t-statistical values were significant at the 0.001 level]

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |               | NTOBIN'S Q 2003    |               | NROE 2003          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2060             |               | 0.1291             |               | 0.1892             |               | 0.1225             |               |
| R <sup>2</sup>                   | 0.2781             |               | 0.2083             |               | 0.2630             |               | 0.2023             |               |
| F                                | 3.8531             |               | 2.6307             |               | 3.5677             |               | 2.5359             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | -0.1886            | -0.9200       | -0.1667            | -0.7767       | -0.2652            | -1.2807       | -0.1062            | -0.4929       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>NAUACF02</b>                  | 0.0390             | 0.4978        | -0.0196            | -0.2394       | 0.0549             | 0.6944        | -0.0017            | -0.0202       |
| <b>NAPACT02</b>                  | -0.1324            | -1.5263       | 0.0265             | 0.2913        | -0.1474            | -1.6821*      | -0.0200            | -0.2191       |
| <b>NACBUS02</b>                  | 0.0305             | 0.3749        | 0.0728             | 0.8537        | -0.0098            | -0.1187       | 0.1265             | 1.4786        |
| <b>NACLAW02</b>                  | -0.0863            | -1.0139       | 0.0868             | 0.9743        | 0.0040             | 0.0463        | 0.0126             | 0.1410        |
| <b>NACSEC02</b>                  | -0.0650            | -0.4858       | 0.1833             | 1.3080        | -0.0625            | -0.4618       | -0.0715            | -0.5081       |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET02</b>                   | -0.2789            | -3.0682***    | 0.3945             | 4.1440***     | -0.2333            | -2.5398**     | 0.3222             | 3.3714***     |
| <b>NDEQ02</b>                    | 0.2020             | 2.8141***     |                    |               | 0.3399             | 4.6863***     |                    |               |
| <b>NFAMDI02</b>                  | -0.1854            | -2.4453**     |                    |               |                    |               |                    |               |
| <b>NBDSZ02</b>                   |                    |               |                    |               |                    |               | 0.1319             | 1.8239*       |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.9781            | -4.1941       |                    |               | -0.8864            | -3.7616***    |                    |               |
| <b>FIN</b>                       |                    |               |                    |               | -0.5135            | -1.8918*      |                    |               |

**Table 8.20 : Audit Committee Competency and Firm Performance – OLS 6(b)**  
**The Examination of Audit Committee Competency in 2003 and Firm Performance in 2003 and 2004**  
**(The Testing of HACKNOW 1, 2, 3, 4, and 5)**

AC = Audit Committee, NAUACF = Proportion of AC members with accounting and finance background, NAPACT = Proportion of AC members with practising accountant experience, NACBUS = Proportion of AC members with business/management related background, NACLAW = Proportion of audit committee members with a law background, NACSEC = Proportion of AC members with company secretary experience, NASET = Total assets, NDEQ = Debt to equity ratio, NFAMDI = Proportion of family-member directors, NBDSZ = Size of Board of directors, NFINK = Proportion of directors with finance background, NBDSZ = Size of Board of directors, MAINB = Main Board firms, PROP = Property industry, CONSTR = Construction industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated  $VIF$  level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values were significant at the 0.1 level]

| Performance Measure              | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2259             |               | 0.1741             |               | 0.0529             |               | 0.1220             |               |
| R <sup>2</sup>                   | 0.2963             |               | 0.2492             |               | 0.1410             |               | 0.2037             |               |
| F                                | 4.2100             |               | 3.3193             |               | 1.6006             |               | 2.4935             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | -0.4178            | -2.1327**     | 0.0844             | 0.4170        | -0.2772            | -1.2650       | -0.0999            | -0.4737       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| NAUACF03                         | 0.1056             | 1.2614        | -0.1137            | -1.3158       | -0.0006            | -0.0065       | -0.0591            | -0.6562       |
| NAPACT03                         | -0.0928            | -1.1556       | 0.0803             | 0.9674        | -0.0185            | -0.2054       | 0.1776             | 2.0548**      |
| NACBUS03                         | 0.0595             | 0.7297        | -0.0512            | -0.6076       | 0.0834             | 0.9146        | 0.0107             | 0.1224        |
| NACLAW03                         | 0.1007             | 1.2120        | 0.0155             | 0.1800        | -0.0444            | -0.4770       | 0.1529             | 1.7095*       |
| NACSEC03                         | -0.1818            | -1.2651       | -0.1435            | -0.9667       | -0.1713            | -1.0660       | 0.0269             | 0.1737        |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| NASET03                          | -0.2949            | -3.1781***    | 0.4479             | 4.6742***     |                    |               | 0.2520             | 2.5241**      |
| NDEQ03                           | 0.3252             | 4.6715***     |                    |               |                    |               |                    |               |
| NFINK03                          | 0.1529             | 1.8717*       | 0.1655             | 1.9609*       |                    |               |                    |               |
| NFAMDI03                         |                    |               |                    |               |                    |               |                    |               |
| NBDSZ03                          |                    |               | 0.1184             | 1.6615*       |                    |               |                    |               |
| AUD503                           | 0.3093             | 2.1945**      |                    |               | 0.3855             | 2.4453**      |                    |               |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| MAINB                            | 0.2982             | 1.6704*       |                    |               |                    |               |                    |               |
| PROP                             | -0.8172            | -3.6169***    | -0.4113            | -1.7623*      | -0.5449            | -2.1562**     | -0.4062            | -1.6708*      |
| CONSTR                           |                    |               |                    |               |                    |               | -0.4825            | -1.7539*      |
| FIN                              | -0.5245            | -1.9802**     | -0.5171            | -1.8904*      |                    |               |                    |               |

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Table 8.21 presents a summary of the findings for the impact of audit committee competency on firm performance

**Table 8.21: Summary of Findings for the Impact of Audit Committee’s Competency on Firm Performance**

| <i>Audit Committee’s Competency (OLS 6)</i>                                                      |                                 |                       |
|--------------------------------------------------------------------------------------------------|---------------------------------|-----------------------|
| Hypothesis HACKNOW                                                                               | Postulated Relationship (+/-/?) | Results               |
| HACKNOW 1: <i>Proportion of AC members with ACF background (NAUACF)</i>                          | +                               | Not Supported         |
| HACKNOW 2: <i>Proportion of AC members with PAE (NACPACT)</i>                                    | +                               | Supported             |
| HACKNOW 3: <i>Proportion of AC members with business/ management related background (NACBUS)</i> | ?                               | ?                     |
| HACKNOW 4: <i>Proportion of AC members with law background (NACLAW)</i>                          | ?                               | Positive Relationship |
| HACKNOW 5: <i>Proportion of AC members with company secretary experience (NACSEC)</i>            | ?                               | ?                     |

*AC = Audit Committee; ACF = Accounting and Finance; PAE = Practising Accountant Experience*

**8.2.3.1 Discussions of the Impact of Audit Committee Competency on Firm Performance**  
**--- OLS 6 Results**

As reported in section 8.2.3, the contribution of audit committee members’ competencies on firm performance was observed with respect to audit committee members possessing accounting practising accountant experience (NAPACT) and legal background (NACLAW). The results provided empirical evidence of the importance of aforementioned expertise in enhancing audit committee oversight responsibilities.

On the other hand, this result was in contrary to Elson (1996) argument that the ability of outside director with law and financial background to carry out their oversight duties appropriately may be affected when their appointments by management were to perform professional service for the firm. The significance of financial expert audit committee members with practising

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accountant experience has been emphasised by Knapp (1987), Libby and Frederick (1990), DeZoort (1997, 1998), DeZoort and Salterio (2001) and Carcello and Neal (2006), in their studies of the impact of audit committee financial expertise on audit committee effectiveness. Further, audit committee oversight of firm financial reporting practice required it to evaluate firm conformance to Securities Exchange and Securities Commission rules and accounting and auditing standards.

Thus, audit committee members with a legal background will be able to ensure that the information disclosed by companies in their annual report is properly presented to avoid any future litigation against the firm or its board of directors (see Chan and Lau, 2003). Also, legal expert advice and counsel (see Baysinger and Butler, 1985 and Verschoor, 1993) is important in deciding and determining the committee's actions when the audit committee and/or auditor have found a financial and/or regulatory fraud in the firm's financial reporting procedures (see Uzun et al., 2004). Moreover, Chan and Lau (2003) recognised the significance of business lawyer knowledge in assisting other directors' understanding of their legal duties in the firm.

On the other hand, OLS 6 results reported an insignificant impact between the proportion of audit committee members with accounting and finance background (**NAUACF**), business/management related background (**NACBUS**) and company secretary experience (**NACSEC**), and firm performance. Notably, technical knowledge and experience in accounting and auditing areas are significant to provide a good quality of financial assessment of the firm and in reporting and rules compliance (Tan and Kao, 1999; Gendron et al., 2004; Defond et al., 2005, Carcello et al., 2006). Importantly, DeZoort (1998) argued, audit committee members who

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are able to contribute more related and sufficient inputs by highlighting other potential aspects and supplementing additional information to oversight tasks will strategically improve the credibility of the collective decisions made by the committee.

### 8.3 Nomination Committee and Firm Performance

The importance of the nomination committee in the firm and the impact of its establishment on firm performance was examined by research model OLS 7, whilst OLS 8 investigated the impact of nomination committee attributes on firm performance. The following sections discussed the results of OLS 7 and OLS 8.

#### 8.3.1 *Nomination Committee Establishment (NCEXIST) and Firm Performance – OLS 7*

Tables 8.22 and 8.23 respectively present the regression results for model OLS 6(a) [i.e. regression of NCEXIST and specified nomination committee establishment variables in 2002 with respective firm performance 2002 and 2003] and model OLS 6(b) [i.e. regression of NCEXIST and specified nomination committee establishment variables in 2003 with respective firm performance 2003 and 2004].

HNC 1 hypothesised that the establishment of a nomination committee in the firm (NCEXIST) will have a positive impact on firm performance. Results for model OLS 7(a) [see Table 8.22] and OLS 7(b) [see Table 8.23] respectively indicated a significant negative relationship between NCEXIST in 2002 and NTobin's Q in 2002 ( $\beta = -0.32$  ;  $p = 0.1$ ), and between NCEXIST in 2003 and NTobin's Q in 2003 ( $\beta = -0.37$  ;  $p = 0.05$ ), and between NCEXIST in 2003 and NROE in 2003 ( $\beta = -0.33$  ;  $p = 0.1$ ) and NROE in 2004 ( $\beta = -0.54$  ;  $p = 0.01$ ).

**Table 8.22 : Nomination Committee Establishment and Firm Performance**  
**The Examination of Nomination Committee Establishment (NCEXIST) in 2002 and Firm Performance 2002 and 2003— OLS 7(a)**  
**(The Testing of HNC 1)**

NCEXIST = The establishment of nomination committee in the firm, SRI = Presence of senior independent director on the board, NFAMDI = Proportion of family-member directors, NFORS = Proportion of specific foreign directors, NASET = Total Assets, NDEQ = Debt to equity ratio, NBDSZ = Size of Board of directors, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach

*[ Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>u</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values were significant at the 0.001 level]*

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |               | NTOBIN'S Q 2003    |               | NROE 2003          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2477             |               | 0.1522             |               | 0.2268             |               | 0.1581             |               |
| R <sup>2</sup>                   | 0.3195             |               | 0.2331             |               | 0.3006             |               | 0.2385             |               |
| F                                | 4.4498             |               | 2.8809             |               | 4.0726             |               | 2.9677             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | 0.2689             | 1.1982        | -0.2270            | -0.9530       | 0.0456             | 0.2006        | 0.0124             | 0.0524        |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>NCEXIST02</b>                 | -0.3222            | -1.9352*      | 0.0323             | 0.1828        | -0.2404            | -1.4242       | -0.2570            | -1.4594       |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET02</b>                   | -0.2646            | -2.8949***    | 0.3727             | 3.8404***     | -0.2477            | -2.6727***    | 0.3077             | 3.1821***     |
| <b>NDEQ02</b>                    | 0.1641             | 2.3094**      |                    |               | 0.3193             | 4.4317***     |                    |               |
| <b>SRI02</b>                     |                    |               |                    |               |                    |               | 0.3547             | 2.7012***     |
| <b>NFAMDI02</b>                  | -0.1985            | -2.1770**     |                    |               |                    |               |                    |               |
| <b>NFORS02</b>                   | 0.1595             | 1.6624*       |                    |               |                    |               |                    |               |
| <b>NBDSZ02</b>                   |                    |               |                    |               |                    |               | 0.1268             | 1.6954*       |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.8586            | -3.8527***    |                    |               | -0.7378            | -3.2655***    |                    |               |
| <b>CONSTR</b>                    | 0.4971             | 2.0089**      |                    |               | 0.5568             | 2.2195**      |                    |               |
| <b>FIN</b>                       |                    |               |                    |               | -0.5360            | -2.0585***    |                    |               |



**Table 8.23 : Nomination Committee Establishment and Firm Performance**  
**The Examination of Nomination Committee Establishment (NCEXIST) in 2003 and Firm Performance 2003 and 2004-- OLS 7(b)**  
**(The Testing of HNC 1)**

NCEXIST = The establishment of nomination committee in the firm, NINED = Proportion of Independent Directors, SRI = Presence of senior independent director on the board, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, CHIN = Board's Chairman INED, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, NBDSZ = Size of Board of directors, NASET = Total Assets, NDEQ = Debt to equity ratio, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 03= Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index: less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>u</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values were significant at the 0.1 level]

| Performance Measure              | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2733             |               | 0.2330             |               | 0.0471             |               | 0.1560             |               |
| R <sup>2</sup>                   | 0.3427             |               | 0.3062             |               | 0.1401             |               | 0.2385             |               |
| F                                | 4.9400             |               | 4.1830             |               | 1.5057             |               | 2.8928             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | 0.0950             | 0.4208        | 0.1905             | 0.8216        | -0.0542            | -0.2075       | 0.2158             | 0.8780        |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>NCEXIST03</b>                 | -0.3699            | -2.1785**     | -0.3293            | -1.8881*      | -0.0313            | -0.1591       | -0.5391            | -2.9161***    |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET03</b>                   | -0.3269            | -3.6033***    | 0.4269             | 4.5806***     |                    |               | 0.2564             | 2.5950**      |
| <b>NDEQ03</b>                    | 0.3077             | 4.4716***     |                    |               |                    |               |                    |               |
| <b>NINED03</b>                   | 0.1359             | 2.0729**      | -0.1732            | -2.5722**     |                    |               |                    |               |
| <b>SRI03</b>                     |                    |               | 0.3229             | 2.6421***     |                    |               |                    |               |
| <b>EXCEO03</b>                   |                    |               | 0.3387             | 2.3573**      |                    |               | 0.2759             | 1.8112*       |
| <b>CHIN03</b>                    |                    |               |                    |               |                    |               | 0.3584             | 2.1508**      |
| <b>NINSTL03</b>                  | 0.2269             | 2.2305**      |                    |               |                    |               |                    |               |
| <b>NBDZ03</b>                    | 0.1503             | 2.1388**      | 0.1648             | 2.2834**      |                    |               | 0.1480             | 1.9347*       |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.6395            | -2.9284***    | -0.3842            | -1.7126*      | -0.4937            | -1.9523*      |                    |               |
| <b>CONSTR</b>                    | 0.5001             | 2.0032**      |                    |               |                    |               |                    |               |
| <b>FIN</b>                       |                    |               | -0.4824            | -1.8531*      | -0.4927            | -1.6791*      |                    |               |

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**8.3.2 *Nomination Committee Independence Composition and Structure, and Firm Performance*  
- OLS 8**

Tables 8.24 and 8.25 respectively presents the regression results for model OLS 8(a) [i.e. regression of specified nomination committee attributes in 2002 with respective firm performance 2002 and 2003] and model OLS 8(b) [i.e. regression of specified nomination committee attributes in 2003 with respective firm performance 2003 and 2004].

HNC 3 posited that the presence of a senior independent director on the nomination committee (NCSIN) will have a positive impact on firm performance. Similar to previous results of OLS 4(i), 4(ii) and 4(iii) on the impact of the presence of senior independent director on audit committee on firm performance (ACSIN), OLS 8(a) and OLS 8(b) model results [see Tables 8.24 and 8.25] also revealed mixed findings. Specifically, OLS 8(a) indicated significant negative relationship between NCSIN in 2002 and NTobin's Q in 2002 ( $\beta = -0.24; p = 0.1$ ), and significant positive relationship between NCSIN in 2002 and NROE in 2003 ( $\beta = 0.27; p = 0.1$ ). Whilst, OLS 8(b) model results revealed significant positive relationship between pointed NCSIN in 2003 and NROE in 2003 ( $\beta = 0.32; p = 0.05$ ).

With respect to the testing of HNC 5, OLS 8(a) and (b) respectively indicated that there was a significant negative relationship between the exclusion of CEO, Chief Financial Officer and/or managing director from nomination committee membership (NCXCEO) in 2002 and NTobin's Q in 2002 ( $\beta = -0.39; p = 0.1$ ) and NCXCEO in 2003 with NTobin's Q in 2003 ( $\beta = -0.52; p = 0.05$ ).

**Table 8.24: Nomination Committee Attributes and Firm Performance**  
**The Examination of Nomination Committee Attributes in 2002 and Firm Performance 2002 and 2003—OLS 8(a)**  
**(The Testing of HNC 2, 3, 4, 5, 6 and 7)**

NC = Nomination committee, NNCINED = Proportion of independent directors on nomination committee, NCSIN = Presence of senior independent director on NC, NCFAM = Presence of family members directors on NC, NCXCEO = The exclusion of CEO, CFO and managing director from NC, NCHIN = NC chairman is independent director, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, NFAMDI = Proportion of family-member directors, AUF5 = Firm's external auditor is one of the big 5 audit firms, NBDSZ = Size of Board of directors, NASET = Total Assets, NDEQ = Debt to equity ratio, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym identified the variable that had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index: less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>u</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values are significant at the 0.001 level]

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |               | NTOBIN'S Q 2003    |               | NROE 2003          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2629             |               | 0.1453             |               | 0.2404             |               | 0.1511             |               |
| R <sup>2</sup>                   | 0.3332             |               | 0.2269             |               | 0.3129             |               | 0.2321             |               |
| F                                | 4.7363             |               | 2.7817             |               | 4.3150             |               | 2.8643             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | 0.1461             | 0.5525        | -0.2506            | -0.8799       | -0.1282            | -0.4776       | -0.0952            | -0.3353       |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| NNCINED02                        | -0.0028            | -0.0245       | -0.0275            | -0.2225       | -0.0744            | -0.6391       | -0.1289            | -1.0477       |
| NCSIN02                          | -0.2420            | -1.7555*      | 0.0814             | 0.5486        | -0.2260            | -1.6147       | 0.2731             | 1.8461*       |
| NCFAM02                          | 0.1227             | 0.9948        | 0.0270             | 0.2035        | 0.1282             | 1.0234        | -0.0042            | -0.0319       |
| NCXCEO02                         | -0.3853            | -1.8059*      | 0.3749             | 1.6315        | -0.2902            | -1.3397       | 0.1814             | 0.7923        |
| NCHIN02                          | 0.0033             | 0.0208        | -0.2038            | -1.1896       | 0.1824             | 1.1298        | -0.3038            | -1.7793*      |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| NASET02                          | -0.2794            | -3.0676***    | 0.3787             | 3.8622***     | -0.2541            | -2.7481***    | 0.3221             | 3.2959***     |
| NDEQ02                           | 0.1446             | 2.0621**      |                    |               | 0.2965             | 4.1663***     |                    |               |
| NFAMDI02                         | -0.1637            | -2.0072**     |                    |               |                    |               |                    |               |
| AUF02                            | 0.2417             | 1.7371*       |                    |               |                    |               |                    |               |
| NBDSZ02                          |                    |               |                    |               |                    |               | 0.1268             | 1.7206*       |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| PROP                             | -0.8373            | -3.7563***    |                    |               | -0.7084            | -3.1304***    |                    |               |
| CONSTR                           | 0.4597             | 1.8128*       |                    |               | 0.5610             | 2.1793**      |                    |               |
| FIN                              |                    |               |                    |               | -0.5583            | -2.1558**     |                    |               |

**Table 8.25: Nomination Committee Attributes and Firm Performance**  
**The Examination of Nomination Committee Attributes in 2003 and Firm Performance 2003 and 2004—OLS 8(b)**  
**(The Testing of HNC 2, 3, 4, 5, 6, and 7)**

NC = Nomination committee, BOD = Board of directors, NNCINED = Proportion of independent directors on nomination committee, NCSIN = Presence of senior independent director on NC, NCFAM = Presence of family members directors on NC, NCXCEO = The exclusion of CEO, CFO and managing director from NC, NCHIN = NC chairman is independent director, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, NFAMDI = Proportion of family-member directors, NASET = Total Assets, NDEQ = Debt to equity ratio, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, NBDSZ = Size of Board of directors, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym indicated the variables had been transformed to normal scores using Van der Waerden approach.

[Notes: *F* for the test of multicollinearity, all independent variables indicated  $VIF$  level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); *F* for the test of autocorrelation of errors the significance level for the statistic (*d*) indicated a value greater than the Durbin Watson derived upper limit (*d<sub>u</sub>*); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All *F*-statistical values are significant at the 0.1 level]

| Performance Measure                               | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|---------------------------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| <i>Adj R</i> <sup>2</sup>                         | 0.2711             |               | 0.1866             |               | 0.0512             |               | 0.1264             |               |
| <i>R</i> <sup>2</sup>                             | 0.3407             |               | 0.2642             |               | 0.1439             |               | 0.2117             |               |
| <i>F</i>                                          | 4.8961             |               | 3.4031             |               | 1.5525             |               | 2.4808             |               |
|                                                   | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (<math>\alpha</math>)</b>            | -0.0606            | -0.2508       | 0.0588             | 0.2305        | -0.1500            | -0.5382       | -0.1982            | -0.7418       |
| <i>Explanatory Variables (<math>\beta</math>)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>NNCINED03</b>                                  | 0.1163             | 1.0635        | -0.0017            | -0.0150       | 0.0424             | 0.3362        | -0.1936            | -1.6001       |
| <b>NCSIN03</b>                                    | -0.1489            | -1.1569       | 0.3221             | 2.3683**      | -0.1018            | -0.6851       | 0.1196             | 0.8400        |
| <b>NCFAM03</b>                                    | 0.1778             | 1.5066        | -0.0427            | -0.3425       | 0.0063             | 0.0255        | 0.1396             | 0.5905        |
| <b>NCXCEO03</b>                                   | -0.5241            | -2.4521**     | -0.2087            | -0.9242       | 0.0468             | 0.3438        | -0.0989            | -0.7576       |
| <b>NCHIN03</b>                                    | 0.0466             | 0.2906        | -0.0671            | -0.3966       | -0.0955            | -0.5165       | -0.0908            | -0.5121       |
| <i>Control Variables</i>                          |                    |               |                    |               |                    |               |                    |               |
| <b>NASET03</b>                                    | -0.3543            | -3.8268***    | 0.4205             | 4.2995***     |                    |               | 0.2472             | 2.4139**      |
| <b>NDEQ03</b>                                     | 0.3045             | 4.4180***     |                    |               |                    |               | 0.1484             | 1.9462*       |
| <b>EXCEO03</b>                                    | 0.2702             | 1.9002*       | 0.3309             | 2.2029**      |                    |               |                    |               |
| <b>NINSTL03</b>                                   | 0.2416             | 2.3527**      |                    |               |                    |               |                    |               |
| <b>AUF503</b>                                     | 0.3282             | 2.3414**      |                    |               | 0.3406             | 2.1059**      |                    |               |
| <b>NBDSZ03</b>                                    | 0.1503             | 2.0978**      | 0.1903             | 2.5138**      |                    |               |                    |               |
| <i>Industry Dummy</i>                             |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                                       | -0.5902            | -2.6859***    |                    |               | -0.4587            | -1.8093*      | -0.4042            | -1.6627*      |
| <b>CONSTR</b>                                     | 0.4364             | 1.7730*       |                    |               |                    |               |                    |               |
| <b>FIN</b>                                        | -0.4702            | -1.8519*      |                    |               | -0.4893            | -1.6704*      |                    |               |

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As regards to HNC 7 testing, OLS 8(a) results showed a significant negative relationship between the appointment of a senior independent director as nomination committee chairman (NCHSIN) in 2002 and NROE in 2003 ( $\beta = -0.30; p = 0.1$ ).

On the other hand, OLS 8(a) and OLS 8(b) model results were not statistically significant to support hypotheses HNC 2 [the proportion of independent director on nomination committee (NNCINED)] and HNC 4 [the presence of a family-member director on the nomination committee (NCFAM)].

Table 8.26 presents the summary of findings for the impact of nomination committee establishment and its attributes on firm performance.

**Table 8.26: Summary of Findings of for the Impact of Nomination Committee Establishment and Its Attributes on Firm Performance**

| <b>THE IMPACT OF NOMINATION COMMITTEE ESTABLISHMENT ON FIRM PERFORMANCE (OLS 7)</b> |                                 |               |
|-------------------------------------------------------------------------------------|---------------------------------|---------------|
| Hypothesis HNC                                                                      | Postulated Relationship (+/-/?) | Results       |
| HNC 1: <i>The establishment of a nomination committee in the firm [NCEXIST]</i>     | +                               | Not Supported |
| <b>THE IMPACT OF NOMINATION COMMITTEE'S ATTRIBUTES ON FIRM PERFORMANCE (OLS 8)</b>  |                                 |               |
| Hypothesis HNC                                                                      | Postulated Relationship (+/-/?) | Results       |
| HNC 2: <i>The proportion of INEDs on NC [NCINED]</i>                                | +                               | Not Supported |
| HNC 3: <i>The presence of a SRINED on NC [NCSIN]</i>                                | ?                               | Supported     |
| HNC 4: <i>The presence of FAMDI on NC [NCFAM]</i>                                   | ?                               | ?             |
| HNC 5: <i>The exclusion of CEO, CFO and MD from NC membership [NCXCEO]</i>          | +                               | Not Supported |
| HNC 6: <i>The chairing of NC by INED [NCHIN]</i>                                    | +                               | Not Supported |

*INED = Independent Director; NC = Nomination Committee; SRINED = Senior Independent Director; FAMDI = Family-Member Director; CEO = Chief Executive Director; CFO = Chief Financial Officer, MD = Managing Director.*

**8.3.3 Discussions of the Impact of Nomination Committee Establishment and Its Attributes on Firm Performance --- OLS 7 and OLS 8 Results**

**(I) Nomination Committee Establishment and Firm Performance**

The establishment of nomination committee has been related to the need to form formal and transparent procedures in the selection, replacement and critically, the regular evaluation of board members performance (Carson, 2002). In section 8.3.1, the results of OLS 7(a) and 7(b) models revealed that the impact of nomination committee establishment (NCEXIST) on firm performance was significantly negatively related. Uzun et al., (2004) reported a similar result when observing the impact of the existence of a nomination committee on the incidence of corporate fraud. The governing function of the nomination committee in their studies appeared to be less immediate than that of the audit and remuneration committee to have a positive impact on the monitoring of corporate fraud. Importantly, the establishment of a nomination committee by Malaysian listed companies was still in its early stage of development when the current study was conducted. Some companies may have decided to form the committee merely to comply with Best Practices of Code of Corporate Governance and hence may not have been fully committed to enforcing the committee's governing potential.

With regard to the nomination committee's activities, the committee may not have convened any meeting during the year [see sampled companies Corporate Governance Statement on Nomination Committee's activities], even though one of the committee's policies was to conduct at least one meeting in a year. Moreover, according to the Higgs Report (2003), which examined the corporate practice of FTSE 350 companies, the nomination committee was the least developed board subcommittee. It would appear that in the Higgs Report (2003) and the current study, FTSE 350 nomination committee members and nomination committee members

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of Malaysian listed firms respectively, were not clear of their governing roles in the firm. In mitigating this problem, the Higgs Report (2003) further proposed that the nomination committee should play an active role in the setting of recruitment and retirement programmes for the board members as well as management development and succession planning.

### (II) Nomination Committee Attributes and Firm Performance

MCCG (2001) and Higgs Report (2003) contended that higher proportion of independent director presence in nomination committee composition is vital in the setting of proper and transparent procedures of board members' selection and assessment. In addition, the nomination committee has a duty to identify the human capital need of the firm and the qualities of board of director candidates, namely, their diligence and vigilance, to ensure board members are highly committed and resourceful individuals [Vafeas, 1999(a)]. On the contrary, OLS 8 model findings revealed insignificant relationship between the proportions of independent directors on the nomination committee (**NNCINED**) on firm performance. Moreover, the impact of the appointment of independent director as the committee's (**NCHIN**) on firm performance was significantly negatively related. These circumstances could be related to the lack of nomination committee activities and meetings (see companies' Corporate Governance Statement on Nomination Committee activities) which may have affected their potential to contribute objectively to the governance of board members' nomination and assessment process (see Higgs Report, 2003; Kulasingham, 2003; Uzun et al., 2004).

On the other hand, OLS 8 findings found significant positive relationship between the presence of a senior independent director on the nomination committee (**NCSIN**) and subsequent year

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firm performance. This result supported Fairchild and Li (2005) proposition that, outside directors with various specialist knowledge would be more critical in their valuation of management agendas, namely in this case the management choices of board candidatures and criteria of board members performance.

With respect to the impact of the exclusion of CEO from the committee's membership (**NCXCEO**) on firm performance, OLS 8 model finding gathered that there was significant negative relationship between the two respective variables. Shivdasani and Yermack, (1997) posited that the dominant influence and involvement of the CEO in board members' selection process will undermine the independence and impartiality of independent directors' views and judgement. However, the presence of more than majority independent directors on the nomination committee and independent nomination committee chairman would establish appropriate governing mechanisms to monitor the discretions of the CEO in the nomination of board candidatures (see Long et al., 2000). In addition, when the system of firm's internal control is reliable, Fama and Jensen [1983, (a)] found that the involvement of internal managers in the board members selection process is encouraged.

In addition, OLS 8 revealed that there was no significant relationship between the presence of family member directors on nomination committee (**NCFAM**) and firm performance. As indicated in Table 6.38 (see Chapter 6), less than 10% of the sampled companies had a family member on their nomination committee and this factor may have contributed to the insignificant result obtained on NCFAM relationship with firm performance. Moreover, family members' influences on organisational process have much been examined at board level rather than at



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board subcommittee, indicating that it is more critical to monitor their domineering behaviour in board decision than subcommittee's (see Allen and Panian, 1992; Boeker, 1992 Claessens et al, 2000; Volpin, 2002).

### 8.4 Remuneration Committee and Firm Performance

The significance of the remuneration committee in the firm was examined by investigating the impact of its establishment (OLS 9) and attributes (OLS 10) on firm performance. The following sub-sections address these issues, respectively.

#### 8.4.1 *Remuneration Committee Establishment (RCEXIST) and Firm Performance – OLS 9*

Tables 8.27 and 8.28 respectively present the regression results for model OLS 9(a) [i.e. regression of RCEXIST and remuneration committee establishment in 2002 with respective firm performance 2002 and 2003] and model OLS 9(b) [i.e. regression of RCEXIST and specified remuneration committee establishment in 2003 with respective firm performance 2003 and 2004].

HRC 1 hypothesised that the establishment of a remuneration committee in the firm (RCEXIST) will have a positive impact on firm performance. OLS 9(a) and OLS 9(b) model results respectively revealed a significant negative relationship between RCEXIST in 2002 and NTobin's Q in 2002 ( $\beta = -0.43$ ;  $p = 0.05$ ), NTobin's Q 2003 ( $\beta = -0.35$ ;  $p = 0.05$ ), and NROE in 2003 ( $\beta = -0.31$ ;  $p = 0.1$ ). In addition similar relationship was also observed between RCEXIST in 2003 and NTobin's Q in 2003 ( $\beta = -0.42$ ;  $p = 0.05$ ), and NROE in 2004 ( $\beta = -0.32$ ;  $p = 0.1$ ).

**Table 8.27: Remuneration Committee Establishment and Firm Performance**  
**The examination of Remuneration Committee Establishment (RCEXIST) in 2002 and Firm Performance 2002 and 2003--OLS 9(a)**  
**(The Testing of HRC 1)**

RCEXIST = The establishment of remuneration committee in the firm, SRI = Senior Independent Director, NFAMDI = Proportion of family-member directors, NFORS = Proportion of specific foreign directors, NBDSZ = Size of Board of directors, NASET = Total Asset, NDEQ = Debt to equity ratio, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym indicated the variables had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (d<sub>U</sub>); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values are significant at the 0.001 level]

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |               | NTOBIN'S Q 2003    |               | NROE 2003          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2571             |               | 0.1526             |               | 0.2348             |               | 0.1610             |               |
| R <sup>2</sup>                   | 0.3280             |               | 0.2335             |               | 0.3079             |               | 0.2411             |               |
| F                                | 4.6261             |               | 2.8863             |               | 4.2150             |               | 3.0110             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | 0.3853             | 1.6503        | -0.2559            | -1.0265       | 0.1603             | 0.6767        | 0.0736             | 0.2967        |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>RCEXIST02</b>                 | -0.4289            | -2.5124**     | 0.0632             | 0.3464        | -0.3525            | -2.0348**     | -0.3051            | -1.6821*      |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET02</b>                   | -0.2574            | -2.8310***    | 0.3714             | 3.8249***     | -0.2415            | -2.6167***    | 0.3125             | 3.2345***     |
| <b>NDEQ02</b>                    | 0.1570             | 2.2192**      |                    |               | 0.3124             | 4.3510***     |                    |               |
| <b>SRI02</b>                     |                    |               |                    |               |                    |               | 0.3562             | 2.7197***     |
| <b>NFAMDI02</b>                  | -0.1970            | -2.1751**     |                    |               |                    |               |                    |               |
| <b>NFORS02</b>                   | 0.1664             | 1.7654*       |                    |               |                    |               |                    |               |
| <b>NBDSZ02</b>                   |                    |               |                    |               |                    |               | 0.1312             | 1.7556*       |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.8590            | -3.8790***    |                    |               | -0.7377            | -3.2823***    |                    |               |
| <b>CONSTR</b>                    | 0.5009             | 2.0397**      |                    |               | 0.5633             | 2.2600**      |                    |               |
| <b>FIN</b>                       |                    |               |                    |               | -0.5128            | -1.9761**     |                    |               |

**Table 8.28: Remuneration Committee Establishment and Firm Performance**  
**The Examination of Remuneration Committee Establishment in 2003 and Firm Performance 2003 and 2004—OLS 9(b)**  
**(The Testing of HRC 1)**

RCEXIST = The establishment of remuneration committee in the firm, NINED = Proportion of Independent Directors, SRI = Senior Independent Director, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, CHIN = Board's Chairman INED, NFORS = Proportion of specific foreign director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, NBDSZ = Size of Board of directors, NASET = Total Asset, NDEQ = Debt to equity ratio, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym indicated the variables had been transformed to normal scores using Van der Waerden approach.

/ Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All F-statistical values are significant at the 0.1 level

| Performance Measure              | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|----------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| Adj R <sup>2</sup>               | 0.2772             |               | 0.2234             |               | 0.0470             |               | 0.1317             |               |
| R <sup>2</sup>                   | 0.3462             |               | 0.2976             |               | 0.1401             |               | 0.2165             |               |
| F                                | 5.0184             |               | 4.0142             |               | 1.5048             |               | 2.5523             |               |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (α)</b>             | 0.1425             | 0.6214        | 0.0896             | 0.3768        | 1.5048             | 1.5048        | 0.0653             | 0.2570        |
| <i>Explanatory Variables (β)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>RCEXIST03</b>                 | -0.4180            | -2.4194**     | -0.1845            | -1.0302       | -0.0926            | -0.3475       | -0.3214            | -1.6793*      |
| <i>Control Variables</i>         |                    |               |                    |               |                    |               |                    |               |
| <b>NASET03</b>                   | -0.3296            | -3.6459***    | 0.4210             | 4.4926***     |                    |               | 0.2470             | 2.4672**      |
| <b>NDEQ03</b>                    | 0.3163             | 4.6441***     |                    |               |                    |               | 0.1346             | 1.7850*       |
| <b>NINED03</b>                   | 0.1340             | 2.0492**      | -0.1704            | -2.5140**     |                    |               |                    |               |
| <b>SRI03</b>                     |                    |               | 0.3108             | 2.5289**      |                    |               |                    |               |
| <b>EXCEO03</b>                   |                    |               | 0.3314             | 2.2935**      |                    |               | 0.2643             | 1.7113*       |
| <b>CHIN03</b>                    |                    |               |                    |               |                    |               | 0.3361             | 1.9891**      |
| <b>NFORS03</b>                   | 0.1624             | 1.7815*       |                    |               |                    |               |                    |               |
| <b>NINSTL03</b>                  | 0.2099             | 2.0469**      |                    |               |                    |               | 0.1892             | 1.6657*       |
| <b>NBDSZ03</b>                   | 0.1485             | 2.1349**      | 0.1478             | 2.0506**      |                    |               |                    |               |
| <i>Industry Dummy</i>            |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                      | -0.6456            | -2.9671***    | -0.4005            | -1.7755*      | -0.4974            | -1.9688*      |                    |               |
| <b>CONSTR</b>                    | 0.4876             | 1.9655*       |                    |               |                    |               |                    |               |
| <b>FIN</b>                       |                    |               | -0.4871            | -1.8576*      | -0.4965            | -1.6905*      |                    |               |

8.4.2 *Remuneration Committee Independence and Structure, and Firm Performance*  
– OLS 10

Tables 8.29 and 8.30 respectively present the regression results of model OLS 10(a) [i.e. regression of specified remuneration committee attributes in 2002 with respective firm performance 2002 and 2003] and model OLS 10(b) [i.e. regression of specified remuneration committee attributes in 2003 with respective firm performance 2003 and 2004].

Hypothesis HRC 2 hypothesised that the proportion of independent directors on the remuneration committee (NRCINED) will have a positive impact on firm performance. OLS 10 (a) and (b) results reported mixed findings for the relationship between RCINED and firm performance. As regards to NRCINED in 2002, a significant negative relationship was found with NROE in 2003 ( $\beta = -0.18$ ;  $p = 0.1$ ). Similarly, a significant negative relationship was also noted between NRCINED in 2003 and NROE in 2003 ( $\beta = -0.22$ ;  $p = 0.05$ ), and NROE in 2004 ( $\beta = -0.19$ ;  $p = 0.1$ ). However, a significant positive relationship was identified between NRCINED in 2003 and NTobin's Q in 2004 ( $\beta = 0.20$ ;  $p = 0.1$ ).

In addition, HRC 3 postulated that the presence of a senior independent director (RCSIN) in the remuneration committee will have a positive impact on firm performance. Consistent with OLS 4 and OLS 8 model findings on the impact of the presence of a senior independent director on their committee on subsequent year firm performance, OLS 10(a) and 10(b) model results also showed a significant positive relationship between RCSIN and firm performance. Specifically, there existed significant positive relationship between RCSIN in 2002 and NROE in 2003 ( $\beta = 0.31$ ;  $p = 0.05$ ) and, between RCSIN in 2003 and NROE in 2003 ( $\beta = 0.39$ ;  $p = 0.01$ ).

**Table 8.29: Remuneration Committee Attributes and Firm Performance**  
**The Examination of Remuneration Committee Attributes in 2002 and Firm Performance 2003 and 2004—OLS 10(a)**  
**(The Testing of HRC 2, 3, 4, 5 and 6)**

RC = Remuneration committee, RCINED = Proportion of independent directors in remuneration committee, RCSIN = Presence of senior independent director on RC, RCFAM = Presence of senior independent director on RC, RCXCEO = The exclusion of CEO, CFO and managing director from RC, RCHIN = RC chairman is independent director, NFAMDI = Proportion of family-member directors, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, NBDSZ = Size of Board of directors, NASET = Total Assets, NDEQ = Debt to equity ratio, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 02 = Year 2002, 03 = Year 2003, A letter N at the front of respective variable's acronym indicated the variables had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated VIF level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All t-statistical values are significant at 0.001 level]

| Performance Measure              | NTOBIN'S Q 2002    |               | NROE 2002          |           | NTOBIN'S Q 2003    |            | NROE 2003          |           |
|----------------------------------|--------------------|---------------|--------------------|-----------|--------------------|------------|--------------------|-----------|
| Adj R <sup>2</sup>               | 0.2489             |               | 0.1487             |           | 0.2194             |            | 0.1661             |           |
| R <sup>2</sup>                   | 0.3206             |               | 0.2299             |           | 0.2939             |            | 0.2457             |           |
| F                                | 4.4721             |               | 2.8296             |           | 3.9452             |            | 3.0870             |           |
|                                  | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t</u>  | <u>Coefficient</u> | <u>t</u>   | <u>Coefficient</u> | <u>t</u>  |
| <b>Intercept (α)</b>             | -0.0045            | -0.0199       | -0.1374            | -0.5690   | -0.0792            | -0.3428    | -0.0345            | -0.1443   |
| <i>Explanatory Variables (β)</i> |                    |               |                    |           |                    |            |                    |           |
| <b>NRCINED02</b>                 | -0.0537            | -0.5325       | -0.0948            | -0.8833   | 0.0403             | 0.3920     | -0.1799            | -1.6944*  |
| <b>RCSIN02</b>                   | -0.0974            | -0.6783       | 0.0810             | 0.5297    | -0.0775            | -0.5294    | 0.3062             | 2.0233**  |
| <b>RCFAM02</b>                   | 0.1200             | 0.7170        | 0.3489             | 1.9588*   | -0.0178            | -0.1042    | 0.1884             | 1.0685    |
| <b>RCXCEO02</b>                  | -0.1745            | -1.2612       | 0.1360             | 0.9232    | -0.1175            | -0.8331    | 0.0667             | 0.4575    |
| <b>RCHIN02</b>                   | -0.1783            | -1.1149       | -0.0645            | -0.3785   | -0.2361            | -1.4479    | -0.2180            | -1.2936   |
| <i>Control Variables</i>         |                    |               |                    |           |                    |            |                    |           |
| <b>NASET02</b>                   | -0.2768            | -3.0135***    | 0.3981             | 4.0709*** | -0.2540            | -2.7123*** | 0.3377             | 3.4891*** |
| <b>NDEQ02</b>                    | 0.1773             | 2.5474**      |                    |           | 0.3220             | 4.5380***  |                    |           |
| <b>NFAMDI02</b>                  | -0.1661            | -1.8804*      |                    |           |                    |            |                    |           |
| <b>NINSTL02</b>                  |                    |               |                    |           | 0.1841             | 1.8025*    |                    |           |
| <b>NBDSZ02</b>                   |                    |               |                    |           |                    |            | 0.1230             | 1.6954*   |
| <i>Industry Dummy</i>            |                    |               |                    |           |                    |            |                    |           |
| <b>PROP</b>                      | -0.8948            | -3.9291**     |                    |           | -0.7413            | -3.1930*** |                    |           |
| <b>CONSTR</b>                    | 0.5450             | 2.1890**      |                    |           | 0.5818             | 2.2922**   |                    |           |
| <b>FIN</b>                       |                    |               |                    |           | -0.4748            | -1.7939*   |                    |           |

**Table 8.30: Remuneration Committee Attributes and Firm Performance**  
**The Examination of Remuneration Committee Attributes in 2003 and Firm Performance 2003 and 2004—OLS 10(b)**  
**(The Testing of HRC 2, 3, 4, 5, and 6)**

RC = Remuneration committee, RCINED = Proportion of independent directors in remuneration committee, RCSIN = Presence of senior independent director on RC, RCFAM = Presence of senior independent director on RC, RCXCEO = The exclusion of CEO, CFO and managing director from RC, RCHIN = RC chairman is independent director, EXCEO = Exclusion of CEO, CFO, COO and Managing Director, NINSTL = Total Proportion of Government Agencies', Public Listed Companies'/Corporations' and Other Institutions' substantial equity holdings, AUF5 = Firm's external auditor is one of the big 5 audit firms, NBDSZ = Size of Board of directors, NASET = Total Assets, NDEQ = Debt to equity ratio, PROP = Property Industry, CONSTR = Construction Industry, FIN = Finance Industry, 03 = Year 2003, 04 = Year 2004, A letter N at the front of respective variable's acronym indicated the variables had been transformed to normal scores using Van der Waerden approach.

[Notes: For the test of multicollinearity, all independent variables indicated  $VIF$  level below 3, condition index less than 15 and not more than one variance proportion greater than 0.50 in their respective dimension (row); For the test of autocorrelation of errors the significance level for the Durbin Watson statistic (d) indicated a value greater than the Durbin Watson derived upper limit (du); Statistical significance level: 0.1 (\*), 0.05 (\*\*), 0.01 (\*\*\*) ; All  $F$ -statistical values are significant at 0.05 level]

| Performance Measure                               | NTOBIN'S Q 2003    |               | NROE 2003          |               | NTOBIN'S Q 2004    |               | NROE 2004          |               |
|---------------------------------------------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|---------------|
| <i>Adj R<sup>2</sup></i>                          | 0.2590             |               | 0.2102             |               | 0.0656             |               | 0.1205             |               |
| <i>R<sup>2</sup></i>                              | 0.3297             |               | 0.2856             |               | 0.1568             |               | 0.2064             |               |
| <i>F</i>                                          | 4.6613             |               | 3.7884             |               | 1.7185             |               | 2.4032             |               |
|                                                   | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> | <u>Coefficient</u> | <u>t-stat</u> |
| <b>Intercept (<math>\alpha</math>)</b>            | -0.1975            | -0.8579       | -0.0428            | -0.1801       | -0.0434            | -0.1661       | -0.1848            | -0.7293       |
| <i>Explanatory Variables (<math>\beta</math>)</i> |                    |               |                    |               |                    |               |                    |               |
| <b>NRCINED03</b>                                  | -0.0876            | -0.9093       | -0.2181            | -2.1931**     | 0.1980             | 1.8104*       | -0.1923            | -1.8138*      |
| <b>RCSIN03</b>                                    | -0.1492            | -1.1403       | 0.3858             | 2.8567***     | -0.0932            | -0.6275       | -0.0549            | -0.3816       |
| <b>RCFAM03</b>                                    | -0.1733            | -1.0543       | -0.2372            | -1.3976       | -0.0265            | -0.1420       | 0.0160             | 0.0884        |
| <b>RCXCEO03</b>                                   | 0.0258             | 0.1686        | 0.1139             | 0.7210        | -0.1211            | -0.6966       | 0.1531             | 0.9088        |
| <b>RCHIN03</b>                                    | -0.0811            | -0.5152       | -0.0086            | -0.0531       | -0.2252            | -1.2607       | 0.1025             | 0.5919        |
| <i>Control Variables</i>                          |                    |               |                    |               |                    |               |                    |               |
| <b>NASET03</b>                                    | -0.3067            | -3.2949***    | 0.4567             | 4.7522***     | -0.1749            | -1.6552*      | 0.2449             | 2.3903**      |
| <b>NDEQ03</b>                                     | 0.3287             | 4.7414***     |                    |               |                    |               | 0.1642             | 2.1507**      |
| <b>EXCEO03</b>                                    |                    |               | 0.2863             | 1.8696*       |                    |               |                    |               |
| <b>NINSTL03</b>                                   | 0.1973             | 1.8674*       |                    |               |                    |               |                    |               |
| <b>AUF503</b>                                     | 0.2432             | 1.7228*       |                    |               | 0.3551             | 2.2153**      |                    |               |
| <b>NBDSZ03</b>                                    |                    |               | 0.1837             | 2.5884**      |                    |               |                    |               |
| <i>Industry Dummy</i>                             |                    |               |                    |               |                    |               |                    |               |
| <b>PROP</b>                                       | -0.7260            | -3.2262***    | -0.4245            | -1.8272*      |                    |               | -0.4732            | -1.9101*      |
| <b>CONSTR</b>                                     | 0.4409             | 1.7881*       |                    |               |                    |               | -0.4526            | -1.6675*      |
| <b>FIN</b>                                        | -0.4509            | -1.7544*      |                    |               |                    |               |                    |               |

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Furthermore, it was hypothesised by HRC 4 that the presence of a family member on the remuneration committee (RCFAM) will have an impact on firm performance. OLS 10(a) results revealed a significant positive relationship between RCFAM in 2002 and NROE in 2002 ( $\beta = 0.35; p = 0.1$ ).

Results derived from testing HRC 5 (the exclusion of CEO, CFO and/or managing director from the remuneration committee) and HRC 6 (the appointment of independent director as remuneration committee chairman) were not statistically significant. Subsequently, Table 8.31 presents the summary of findings for the impact of remuneration committee establishment and its attributes on firm performance.

**Table 8.31: Summary of Findings of Remuneration Committee Establishment and Its Attributes on Firm Performance**

| <b>THE IMPACT OF REMUNERATION COMMITTEE ESTABLISHMENT ON FIRM PERFORMANCE (OLS 9)</b> |                                 |                       |
|---------------------------------------------------------------------------------------|---------------------------------|-----------------------|
| Hypothesis HNC                                                                        | Postulated Relationship (+/-/?) | Results               |
| HNC 1: <i>The establishment of nomination committee in the firm [RCEXIST]</i>         | +                               | Not Supported         |
| <b>THE IMPACT OF REMUNERATION COMMITTEE'S ATTRIBUTES ON FIRM PERFORMANCE (OLS 10)</b> |                                 |                       |
| Hypothesis HNC                                                                        | Postulated Relationship (+/-/?) | Results               |
| HNC 2: <i>The proportion of INEDs on RC [RCINED]</i>                                  | +                               | Supported             |
| HNC 3: <i>The presence of SRINED on RC [RCSIN]</i>                                    | ?                               | Supported             |
| HNC 4: <i>The presence of FAMDI on RC [RCFAM]</i>                                     | ?                               | Positive Relationship |
| HNC 5: <i>The exclusion of CEO, CFO and MD from RC membership [RCXCEO]</i>            | +                               | Not Supported         |
| HNC 6: <i>The chairing of RC by INED [RCHIN]</i>                                      | +                               | Not Supported         |

*INED = Independent Director; RC = Remuneration Committee; SRINED = Senior Independent Director; FAMDI = Family-Member Director; CEO = Chief Executive Director; CFO = Chief Financial Officer, MD = Managing Director;*

8.4.3 **Discussions of the Impact of Remuneration Committee Establishment and Its Attributes on Firm Performance --- OLS 9 and OLS 10 Results**

**(I) Remuneration Committee Establishment and Firm Performance**

Similar to the OLS 7 finding of a significant negative impact of nomination committee establishment on firm performance, OLS 9 model results also revealed a significant negative relationship between remuneration committee establishment and firm performance. Likely the case, the formation of a remuneration committee by Malaysian listed companies was part of their compliance with MCCG 2001 Best Practices guidelines. Where companies had decided not to implement Best Practices, MBSB listing rulings required them to disclose their reasons for non-compliance in their corporate governance statement. The significance of the committee as a board governing committee in the evaluation of executives' compensation policies, schemes and performance would need time to develop (see Yermack, 2004). Moreover, its members would need relevant training and exposure to the committee's underlying function, authority and their oversight role and responsibilities as well as clear objectives (see Forker, 1992, Lipton and Lorsch, 1992, Carson, 2002 and Agrawal and Chadha, 2005), given that the remuneration committee function was previously managed and administrated by the firm's board and/or top executives of the firm.

**(II) Remuneration Committee Attributes and Firm Performance**

Section 8.4.2 of OLS 10 model findings indicated that, the proportion of independent directors (**NRCINED**) on the remuneration committee had a negative impact on firm performance. On the other hand, the research model further revealed of the insignificant relationship between the appointment of independent director as the committee's chairman (**RCHIN**) and firm



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performance. Notably, the presence of a high number of independent directors and independent chairman will ensure an objective and impartial evaluation of executives' remuneration and performance (see Forker, 1992; Greenbury, 1995). In the case of the current study, the examination of the companies remuneration committee activities (see sampled companies Corporate Governance Statement on remuneration committee) seemed to pointed that the lack of governing activities performed by remuneration committee members may have affected the potential of the independent director to contribute to the effectiveness of the committee and hence firm performance (i.e more than half of the sampled companies disclosed the need for their nomination committee to convene at least one meeting in a year, but in actual fact the meeting was not convened).

To further encourage the independent directors' involvement and commitment to undertake their remuneration committee duties responsibly, it is equally important for the firm to ensure that the committee's members have greater understanding and clarification of the function of the remuneration committee. This would include providing them with appropriate corporate governance induction programme to enhance their comprehension of the significance of the committee members' oversight role in governing executives' compensation, and further, to establish proper terms of reference and authority of the committee. Accordingly, committee' members will have a better prospect of accomplishing their duties with diligence and vigilance.

On the other hand, the presence of a senior independent director (**RCSIN**) on the remuneration committee, respectively, had a positive impact on firm performance. Specifically, the presence of a senior independent director on the remuneration committee (**RCSIN**) will strengthen and

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enhance the objectivity, impartiality and credibility of independent directors' judgements, as well as effectiveness, given his/her significant corporate governance experience (see Libby, 1985; Knapp, 1987; DeZoort et al., 2001).

With respect to the significant positive relationship between membership of family-member directors on the remuneration committee (**RCFAM**) and firm performance, this can be linked with their potential to provide better monitoring of non-family managers' actions. In particular, family-member directors' history with the company (whether as founder of the company or descendants of the founder of the company), motivate them to ensure proper governance in the company's business transaction to ensure its prosperity and for the benefit of their next generation (see DeAngelo and DeAngelo, 1985). Moreover, according to McConaughy et al., (1998), a founder's family members have greater abilities to manage the firm efficiently than the founder since the former will be able to use firm's past experience and information to improve current management and operations of the business.

In addition, the study of Ho et al., (2004) on family controlled firms in Hong Kong Stock Exchange showed these companies to be high performers. According to Bruce (2006:88), family-controlled corporations had a greater tendency to inculcate a long-term earnings interest culture than non-family businesses. Hence, the positive impact on firm performance of family member director presence on Malaysian listed companies' remuneration committee may due to his/her awareness of the need to enhance business prosperity with long term firm performance goal, which is imperative for shareholder value creation. However, due to the potentiality for family-member directors to act in their family best interests rather than shareholders, a high

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proportion of independent directors and the presence of a well-respected senior independent director should provide appropriate governance of family member behaviours and conduct in the committee's activities and decisions.

In addition, the exclusion of CEO, CFO and managing director from remuneration committee membership (**RCXCEO**) had no impact on firm performance (see OLS 10). Specifically, the composition of remuneration committee by more than majority independent directors, the appointment of independent remuneration committee chairman and the presence of senior independent director on the nomination committee, established formal and transparent procedures in the setting of executive remuneration and hence ensuring appropriate monitoring of CEO involvement in the setting of executive remuneration policies (See for instance Firstenberg and Malkiel, 1980; Weisbach, 1988; Daily and Dalton, 1993; Borokhovich et al., 1994; Shivdasani and Yermack, 1999; DeZoort and Salterio, 2001; Ferris et al., 2003).

### **8.5 Robustness Tests on the Research Models' Findings**

Several studies have identified the endogeneity problem as one of the factors that may affect the relationship between corporate governance attributes and firm's performance. For instance, Hermalin and Weisbach (1988) and Agrawal and Knoeber (1996) argue that a firm's reformation of corporate governance practice may have been driven by the firm's poor or better performance in previous year. This argument is also supported by Bhagat and Black (2002). On the other hand, Black (2001) contended, when difference firms adopted different governance

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measure for the optimality of their business operation, there is no direct correlation between their corporate governance practice and firm value.

In the case of the current research, Malaysian listed firms' implementation of the Principles and Best Practices of the Corporate Governance Code in 2002 and 2003 were influenced by the mandatory requirement of MBSB Listing Rulings 2001 (see Chapter 15 of the MBSB Listing Rulings 2001). As a result, firm's adoption of the corporate governance practice was not driven by internally determined decisions. Rather, it was due to the external factor namely regulatory requirements. Accordingly, the endogeneity problem was less likely to affect the current study examination of relationship between firm's corporate governance practice and performance (see Black, 2001: 97).

In their study, Drobetz et al., (2004), noted the impact of the endogeneity problem when studying the relationship between corporate governance variables and firm performance. They suggested the use of appropriate control variables to mitigate the causality problem that may be inherent in the relationship between corporate governance variables and firm performance. By employing the control variables proposed by Shin and Stulz (2000), Drobetz et al., 2004 used log total asset as the control variable on firm characteristics. In addition, Drobetz et al., (2004) implemented Black et al.'s (2003) control variable of firm characteristic, namely debt to capital ratio calculated as total debt plus equity. Drobetz et al., (2004) also employed the index effect as another control variable.

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Following Drobetz et al., (2004), the current study has employed firm size, leverage and index effect as part of the research models control variables (see further Chapter 5: Research Hypotheses and Models Development). Further, from the regression results derived from the research models of board of directors (OLS 1, 2 and 3 in Chapter 7) and board subcommittees (OLS 4, 5, 6, 7, 8, 9 and 10 in Chapter 8), in most cases the firm' size and leverage variables had a significant impact on firm performance ( $p = 0.01$ ) and hence provided further explanation of other factors that may had a substantial influence on firm performance other than firms' internal governing mechanisms.

Moreover endogeneity test was carried out to observe potential endogeneous impact of firm performance on explanatory variable. Notably Barnhart et al., (1998) study on board composition effect on corporate performance found managerial ownership and board composition variables were endogenous to firm performance. According to Bound et al., (1995:443) when this circumstance persist, the analyses of the predicted relationship will produce a bias and/or inconsistent estimates of the causal effect of the independent variables on the dependent variables.

In reference to Wooldridge (2000,) the potential of endogeneity problem to affect the causal relationship of corporate governance practice impact on firm performance were examined using two-stage least square (2SLS) analyses of SPSS 12.0. The first step for implementing 2SLS analysis is to identify the instrumental variable for the OLS model to be predicted. According to Black et al., (2006), ideally, an instrumental variable should be an exogenous variable which is

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impartial to dependent variable influence<sup>78</sup> or have no direct association with the outcome (Bound et al., 1995). In particular, instrumental variable should correlate closely with the endogenous variable to produce reliable and consistent estimates of endogenous variable (Black et al., 2006). Hence, the instrumental variables should not have direct causal path to the endogenous variable whose disturbance term is correlated with the problematic causal variable. Correspondingly, 2SLS procedures, an OLS regression analysis of the new model, will produce new predicted values for the endogenous explanatory variables.

For the current study, an instrumental variable of one year lag firm performance measure (i.e. Tobin's  $Q_{t-1}$  and  $ROE_{t-1}$ ) was employed as an instrumental variable in the 2SLS analysis (See, further, Wooldridge, 2000: 289). According to Main et al., (1996), the use of lagged dependent variable as instrumental variable will be able to capture the dynamic of the dependent variable. Subsequently, the 2SLS results obtained, indicated that the correlation between the residuals of firm performance and explanatory variables was not significant. This evidence provided further indicator of the low potential effect of the endogeneity problem in the research models' results.

In addition the robustness of the regression results may also be affected by the problems of autocorrelation, multicollinearity and heteroskedasticity. As indicated by OLS 1 to 10 model results (see Table 7.1 to 8.30), the VIF level (i.e. degree of collinearity amongst independent variables) of the independent variables was below 3. This VIF level is within Hair et al., (1998:193) and Pallant (2005) acceptable VIF value of below 10. Furthermore, collinearity diagnostics results of the independent variables reported a value of condition index less than 15

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<sup>78</sup> In Black et al., (2006) they explain, the influence that the instrumental variable has on the outcome is indirectly namely through its direct impact on the endogenous variables.

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and respectively, the value of the variance proportion in each of the variables' dimension (row) [based on the results obtained from their regression coefficient variance-decomposition matrix] was not greater than 0.50 in more than one cases. These results presented statistical evidence of no multicollinearity problem amongst independent variables (see for instance Belsely et al., 1980, Hair et al., 1998 and Tabachnick and Fidell, 2001: 85, 98).

In terms of autocorrelation problem or correlation amongst residual term, the regression results had produced a Durbin Watson statistical value ( $d$ ) that was higher than Durbin Watson derived upper limit ( $d_u$ ). According to Field (2005) and Maddala (2005:229), when Durbin-Watson statistical value ( $d$ ) is higher than Durbin Watson upper limit ( $d_u$ ), the null hypothesis of no autocorrelation should not be rejected. Moreover, with respect to the heteroskedasticity problem, the F or Lagrange Multiplier (LM) value computed from the White Test for heteroskedasticity (see section 6.6) produced on average a p-value higher than 0.12 . This result provided evidence that the OLS regression models did not violate their homoscedasticity assumption (see Wooldridge, 2000). Hence, the current research regression results were robust and valid.

### 8.6 Conclusion

The current chapter has analysed and discussed study findings relating to the impact of board subcommittees' attributes on firm performance. In terms of the impact of audit committee independence on firm performance, the models' significant findings indicated a significant negative relationship between the presences of wholly independent directors (AUDF), more than majority independent directors (AUGMJ) and majority independent directors (AUDMJ) in the committee's composition and firm performance. However, when the presence of a senior

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independent director (ACSIN) and at least one independent or non-independent audit committee member with practising accountant experience (ACPI and ACPACT) and companies' transparency of the authority of the audit committee to report any violation of the Exchange ruling to the Exchange (RBRE), were investigated together in the audit committee independence model, they were found to have a significant positive impact on firm performance [see Table 8.7]. The effectiveness of audit committee independence was significantly influenced by the presence of these respective factors and consequently the committee's independent composition had a significant impact on firm performance.

With respect to the impact of audit committee leadership on firm performance, the leadership of independent directors with accounting and finance background (ACHACF) was shown to assist effective management (see Table 8.18). Committee members' performance of financial oversight duties will be facilitated by the chairman's regular contact with board's chairman, top management executives and audit lead partner. Further, the proportion of audit committee members with practising accountant experience (NACPACT) and law background (NACLAW) will contribute to the efficiency and effectiveness of the committee's performance of duties and hence firm performance (see Table 8.21).

Findings also revealed that, the establishment of nomination (NCEXIST) and remuneration (RCEXIST) in firms was negatively related to firm performance (see Table 8.26 and 8.31 respectively). Since these committees were at their early stage of development at the time of the study, time was needed to establish their governing role in the firm and committees' members would require relevant exposure and training for their oversight role in the committee. With



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respect to the nomination committee's attributes' impact on firm performance, the presence of senior independent director (NCSIN) in the committee was shown to enhance the contribution of the committee to firm performance (see Table 8.6). However, examination of the exclusion of CEO, CFO or managing director (NCXCEO) from the committee's membership and the appointment of independent remuneration committee's chairman (NCHIN), on firm performance revealed significant negative relationship between the respective variables.

Further, the presence of senior independent director (RCSIN) and family member (RCFAM) on the remuneration committee was shown to have a positive impact on firm performance. The presence of senior independent director can lead the independent director group with his/her corporate governance experience and s/he can appropriately control family-member director unwarranted demands. On the other hand, the observation of the impact of the proportion of independent director on the remuneration committee (RCHSIN) on firm performance indicated a significant negative relationship between the two variables. The lack of activities of remuneration committee explained the low participation of independent director in the committee's oversight duties and hence the consequence of such circumstance on firm performance.

The discussion on the impact of board subcommittees' attributes on firm performance has been limited to the significant results derived from the individual research models. As suggested earlier in chapter 7, the collection of more corporate governance data could extend the current study for time series research and further application of pooled regression analyses. The next chapter, 9, summarises the current research findings and indicates the research finding'

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contribution to assisting investor's evaluation of firm's corporate governance practice and enhancing policy-makers' prospective corporate governance initiatives and rules setting. The limitations of the current research and areas for future study are also identified.

# Chapter 9

## *~Conclusions and Recommendations for Future Research~*

### 9.0 Introduction

This chapter first presents an overview of study findings in relation to the research questions formulated in Chapter One and then indicates the research's contribution to the corporate governance literature. The research findings' contribution to enhancing policy-makers' perspective on corporate governance initiatives and rule setting, and assisting investors' evaluation of firm's corporate governance structure, and corporations' full capitalisation of the value of independent directors' experience, knowledge and aptitudes is then highlighted. The limitations of the research and areas for future study are subsequently identified.

### 9.1 Research Findings

*Research Question 1: Does the independence of board of directors' members from management influence affect a firm's financial performance?*

The current study found that board independence enhanced firm performance when a senior independent director and an independent board's chairman were present on the board, and CEO, CFO, COO or MD was not a board member. The corporate governance experience of the independent director, contributed to his reputation and influence on the board as well as to the board's decision making. In addition, being the leader of the board, independent board chairman had greater control and authority to influence organisational process. Moreover, the absence of top management executives from the board provided independent directors

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with greater freedom to express their independent views or challenged management decisions that were in conflict with shareholders interests.

Furthermore, the negative relationship between the proportion of family member director on the board and firm performance supported the imperativeness of higher independent director presence on the board. These findings provided empirical evidence in support of the significance of board independence as an effective governing mechanism for monitoring family-member director influence on board decisions.

***Research Question 2: Does the structure of the board of directors affect a firm's financial performance?***

With respect to board leadership, the current study found that chairing of the firm's board by an independent director, a non-executive director or founder of the company and separation of board chairman and CEO role, had a positive impact on firm performance. Notably, the appointment of an independent board chairman established an environment conducive for fair debate of critical issues during board meeting(s), setting of relevant and sufficient board agendas for board meetings and appropriate monitoring of board members' and managements' conducts. In addition, non-executive director's business relationship with the firm provided him/her with a better understanding of the firm's business operation and gave him/her the incentive to lead the company appropriately.

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On the other hand, the board led by the founder of the firm would benefit from his/her business and managerial experience as well as enhance monitoring of non-owner managers' action. In addition, the separation of board chairman and CEO position would ensure orderly management of the organisation's activities such that the firm's management and control was not dominated by one person. Thus, structure of the board had a significant impact on firm performance.

***Research Question 3: Do the knowledge and skills of the board of directors' members affect a firm's financial performance?***

Empirical findings indicated that board members with a professional qualification and/or Doctor of Philosophy would enhance firm value given their high level of knowledge and skills and industry experience. Specifically, directors that had finance knowledge and skills and/or attended an executive management programme held by top business universities such as Harvard, Stanford, INSEAD, London Business School, etc. enhanced firm value with their acquirement of relevant technical and practical aspects of a firm's financial management. In addition, the presence of director(s) with law qualifications provided important legal expert advisory service to assist board members understanding of the legislative and regulatory rules and procedures affecting the companies' activities and directors' fiduciary obligations, and hence strengthened board members commitment in overseeing the firm activities. Thus, the empirical findings indicated that the provision of relevant board of director training programmes could enhance board of director management capabilities and their subsequent decision-making and consequently contribute to firm value creation activities.

***Research Question 4: Does the independence of audit committee members from management influence affect a firm's financial performance?***

Empirical findings pointed to the significant importance of an independent quorum on the audit committee and their effectiveness. Moreover, the presence of a senior independent director on the audit committee and committee's member with practising accountant experience appeared to strengthen the influence of independent views and effectiveness as well as those of auditors given his/her corporate governance experience and acquirement of relevant auditing and audit firm experience. However, the presence of a top management executive (i.e. CEO, CFO and/or managing director) with financial knowledge and skills on the committee, would not endanger independent members effectiveness in performing their financial oversight duties objectively and with vigilance and diligence, given that sufficient disclosure had been made about their respective appointment in the company's Audit Committee Report to warrant closer monitoring of their conducts on the committee by independent members, regulators and investors.

Whilst, to gain market trusts of the beneficial aspect of the convening of a separate meeting between independent members of the audit committee and external auditors, the credibility of auditor's opinions and judgements need to be demonstrated justifiably. Further, the productivity of respective parties' collaboration depended on the commitment and effectiveness of the team working between independent audit committee members and the external auditor in pursuing their financial oversight duties responsibly.

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The importance of the audit committee's financial oversight duties in protecting shareholders' interests was further emphasised by its authority to report to the Exchange any breaches by the firm of regulatory rules or its failure to address issues raised by audit committee members. Accordingly, findings indicated that audit committee members' independence from management influence affected a firm's financial performance.

***Research Questions 5: Does the leadership of the audit committee affect a firm's financial performance?***

Empirical evidence pointed to an enhancement in firm performance when the audit committee's chairman possessed accounting and finance experience. Such experience enabled the chairman to lead and manage audit committee members and their activities effectively as well as ensured auditors' productivity.

***Research Question 6: Do the accounting and financial knowledge and skills of audit committee members affect a firm's financial performance?***

The proportion of audit committee members with practical accounting experience and legal background appeared to elevate audit committee members' awareness and abilities to perform their financial oversight responsibilities efficiently and hence lead to better governance of shareholders' investments. Moreover, the appointment of financial experts to the committee with such experience also contributed to the efficiency of committee's activities. Accordingly, the accounting and financial knowledge and skills of audit committee members affected firm's financial performance.

***Research Question 7: Does the formation of nomination and remuneration committees affects a firm's financial performance?***

Empirical findings suggested that the nomination and remuneration committee oversight function of board candidates' nomination and members performance, and executives' compensation policies and appraisal respectively, need to be properly established by firms with relevant induction programmes and training provided to these committees members to raise their awareness and clear understanding of their governing role and its significance in protecting shareholders' interests. Only then can their active participation in these committees' activities be assured and the full potential of each committee's oversight function be reached. Even though the empirical evidence did not indicate that the formation of nomination and remuneration committees affected a firm's financial performance, however, these committees do have the potential to contribute to firm value.

***Research Question 8: Does the independence of nomination and remuneration committee members from management influence affect a firm's financial performance?***

The independent views and judgements of nomination and remuneration committee members will be enhanced when a senior independent director was present in the respective committees. In addition, when the top management executive (i.e. CEO, CFO and managing director) and/or family-member director(s) were present on the respective committees, it became critical to form more than majority independent directors on the nomination and remuneration committee to establish stronger independent stance. Specifically, appropriate and sufficient governance measures were required to control top executives and family-member director(s) domineering



influence on the nomination process of board candidatures and the setting of executives and owner-manager compensation level and policies.

***Research Question 9: Does the structure of nomination and remuneration committees affect a firm's financial performance?***

The aforementioned findings provide empirical evidence for answering both Research Question 8 and 9. The independence of nomination and remuneration is imperative to establish objectivity and impartiality in committees' evaluations and decisions on board nominees and executive compensation payment setting, given that top management executives (i.e. CEO, CFO or managing director) and family-member director may insist on their appointment to these committees. Moreover, the appointment of an independent and experienced independent chairman to these committees would strengthen the independent views and judgements of other independent members especially when top management executives and family members are present in the committee.

## **9.2 Contributions of the Study**

### **(I) *Corporate Governance Literature***

The current study makes several important contributions to the corporate governance literature. Namely, the current study to the author's best knowledge, the first to examine the potential impact of family-member director oversight role in audit, nomination and remuneration committees in Malaysian corporations. In particular, this study has examined the impact of audit committee monitoring effectiveness on firm performance by considering both family-member

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director presence on the committee as well as their proportion on the firm's board. The study findings on family-member director governing role add to the body of knowledge on the corporate governance practice of family-controlled listed companies.

Additionally, this study is the first empirical study conducted in Malaysia to investigate the impact of a senior independent director's governance experience in enhancing the board and its subcommittees' objective and impartial judgements as well as leadership of the firm's governing body. Previously, DeZoort (1997, 1998) and DeZoort and Salterio (2001) have examined the contribution of experienced independent directors on audit committee effectiveness. The current study has extended their evaluation of the importance of independent director with corporate governance experience by examining the impact of senior independent director membership on nomination and remuneration committee effectiveness and hence firm performance.

It is also the first study conducted in Malaysia to identify the need to appoint independent financial experts, not just financial experts, as audit committee members to safeguard and ensure independent member evaluation of firms' reporting practice and internal control process.

### (II) *Policy Makers*

The findings of this study contribute to policy-makers' prospective corporate governance initiatives and rule setting for the following reasons. Empirical evidence emphasised the importance of independent directors' oversight duties on the board and its subcommittees. Specifically, the board and their subcommittees need to perform their respective responsibilities with commitment, vigilance and diligence to ensure effective governing of firm activities and

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hence safeguarding of shareholders' investment with the implementation of value enhancement activities by management.

Moreover, regulatory bodies play a key role in governing firms' corporate governance with the institution of appropriate regulatory framework to monitor firms' corporate behaviours. Namely, the Malaysia Securities Commission, Malaysia Bourse Securities Limited, Malaysia Accounting Standard Board and other professional bodies such as Malaysian Institute of Accountant and Malaysian Association of Institute Chartered and Secretarial Administrators have a pivotal role in developing and establishing effective corporate governance regulatory framework that protect shareholders' interests and at the same time encouraging managers to continually pursue their entrepreneurship motives without feeling being unnecessarily constrained.

For instance, the regulatory bodies support for firms to ensure that their independent directors obtained appropriate understanding and comprehension of the core activities of the firm by providing relevant training, site visit and access to personnel and documents (where necessary) would allow the directors to perform their oversight duties effectively. In particular, it would be useful for the regulatory bodies and public as a whole if independent directors are required to produce a report to the Securities Commission and Stock Exchange of the assistance that they received when performing their monitoring duties. In one hand, the regulatory bodies would be able to receive updates of companies commitment to implement the Codes of Corporate Governance responsibly, namely for prospective assessment of the effectiveness of current Codes Principles and Best Practices. On another, the independent directors would be protected

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against unforeseen legal liability for negligence and this should boost their morale to perform their duties accordingly.

Besides that, Malaysia Institute of Corporate Governance (MICG) also need to ensure that special continuing education and training programmes are set up for corporate directors and other corporate professionals. In particular, independent directors' awareness of the importance of vigilance and diligence in the performance of their oversight duties is critical and substantial for establishing credible and reliable governing body in the corporation.

The Malaysia Securities Commission, Malaysia Bourse Securities Limited, Companies Commission of Malaysia and MICG should also gather information about independent director' views on factors inhibiting their commitment in the organisation given that MBSB listing requirements assure them of the firm's management's cooperation to provide adequate and relevant supply of information, external independent professional consultation and funds to assist them in making informed decisions. Also, independent directors' dissatisfaction with the financial incentives available to them may have affected their performance of oversight role. In this case, policy-makers need to come up with a plan as to how independent directors' shareholdings in the firm can be raised to a substantial stake without affecting their independence, given that current MBSB rulings do not allow them to own 5% or more shares in the firm.

In addition, MBSB revision of the financial expert requirement on the audit committee with a supplementary ruling of the presence of at least one independent financial expert on the

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committee will enhance the objectivity and effectiveness of the committee. In particular, it will reduce the opportunity for a firm's management and owner-managers to control the independent judgements and decisions on the committee through the appointment of their financial expert to the committee.

Given the significant contribution of senior independent directors to strengthening firms' corporate governance practice, Malaysian policy makers need to increase their efforts in promoting the appointment of these highly reputable independent directors in the Malaysian corporations. At the same time, policy-makers need to properly monitor companies description of their senior independent director because this study found two firms had appointed their non-executive director as senior independent director (possibly due to his/her independent director experience in other firms).

To develop and enhance nomination and remuneration committee members' performance of their specific oversight duties, policy makers need to increase their efforts in promoting their greater awareness of and exposure to the significance of these committees' functions and further establish the proper authorities of the committees. Since previously (and was still the case in some listed companies in this study), board of directors and management were primarily responsible for nominating board candidates and setting executives' compensation payments. Further, policy makers need to gather the responses and experiences of directors appointed to nomination and remuneration committees to identify those factors that affect their oversight commitment in the respective committee so that appropriate action can be undertaken to address them.

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Finally policy-makers efforts in establishing and enforcing credible corporate governance practice in the listed firms may further encourage foreign investors' participation and their confidence in the reliability and hence full potential of Malaysia's capital market to provide them with more than average return on their investments.

### (III) *Investors*

The study's findings also have important implications for investors. They should use the opportunity given by firms to contact the senior independent director directly, given firms' provision of the contact number and address of the director in the corporate governance statement of the annual report, to enhance their information need about the board's activities as well as firm's internal activities (where appropriate) on a timely basis. In addition, they should increase their participation in annual general meetings as they are able to communicate directly with the firm's board of directors regarding their efforts in enhancing shareholders' value creation and establishing appropriate governance mechanisms to protect their interests. Even though the audit committee chairman's communication with non-management attendees during the annual general meeting is conducted through the board's chairman, investors should take this opportunity to ask specific questions in respect of any concern about the reliability and credibility of the firm's financial reporting information. Investors may also recommend that the company's board supply additional information about the details of firm's strategic planning and investment activities so that they are able to evaluate how such operations enhance firm performance.

(IV) *Corporations*

In order to capitalise fully on the value of independent director's knowledge, aptitudes and experience, corporations need to alter their views on, attitudes towards and treatment of this human capital on firm's board beyond mere compliance with governance practice guidelines. It is inevitable today that company will engage a certain number of independent directors on boards (due to progressive academicians, institutional investors, regulatory and legislative bodies having demonstrated their importance). Thus, firms, shareholders and stakeholders should start devising strategies to make such directors' roles more productive and value-for-money in terms of board decisions and activities because their mandatory appointment comes at a cost: their fees and other reimbursement entitlements.

**9.3 Limitation of the Study and Future Research**

The current study has examined the impact of Malaysian listed companies' adoption of Principles and Best Practices on the Malaysian Codes of Corporate Governance on board of directors and board subcommittees as at financial year 2002 and 2003 with firm performance in 2002, 2003 and 2004, respectively. Nevertheless, the potential benefits of a firm's implementation of good corporate governance practices may be better captured by its firm performance when the observation period is extended to five years for instance. Yermack (2004) pointed to the importance of conducting a study on board practice over a certain period of time, namely 5 years. He argued that, such time frame will allow better understanding of how outside directors' skills evolve with time, given their lack of knowledge of the company's operations when they first commenced their job in the firm and their reputation's dependence on their past and current working experience. Importantly, after certain period of time they may have

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accumulated the required and relevant knowledge and skills to influence the firm's strategic decision. Future research on this subject may be better undertaken using questionnaires surveys and/or interviews approach to gather details understanding of how directors working environment affected their decision making.

Moreover, a longer period of observation of a firm's corporate governance practice will facilitate a more accurate assessment of the development of the internal governing body, the board of director awareness of and commitment to good corporate governance practices. Further, with time companies may be better able to evaluate and identify those elements of the Code that are particularly relevant to them and contribute to the better management of their business operations and procedures and are in accordance with shareholders' best interests. According to Westphal (1999) there is a potential benefit inherent in the congruency between executive and independent directors' aims and objectives for generating higher firm value.

The current study has examined the contribution of independent directors to firm performance by linking the impact of directors' significance in establishing impartial view and judgements on the board and their related expertise on firm value creation. Future research may extend to include content analysis of the information disclosed and its dissemination in the corporate governance statement section of firms' annual report.

Another research avenue would be to examine the implications of firms disclosing related party transactions for the effectiveness of their internal control system and administration. This type of transaction also requires further identification, examination and disclosure of a company's



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engagement with a wide range of related parties, for example, subsidiaries, directors, employees and suppliers, given the non-recognition of certain transactions by accounting measures, i.e. the provision of free business services by related parties, and potential creative accounting manoeuvres in the recognition and treatment of certain business transactions [see Gordon et al., 2007].

### 9.4 Conclusion

The influence of corporations' governance practices on firm performance has been examined at length, mainly due to the potential of the former to provide security through the monitoring and controlling of corporate misconduct. However, the effectiveness of the governing mechanisms implemented in firms will depend on the actions and commitment of the people designated to conduct such responsibilities (Daily and Dalton, 1993). Without their active, appropriate and sufficient enforcement of oversight duties, their presence in firms will merely fulfil companies' compliance with the regulatory rules and this benefit will not extend to ensuring a safe investment environment for existing and potential investors. Hence, boards of directors and boards' subcommittees' members, especially independent outside directors, need to participate proactively in their discussion with management (Provan, 1980). If management are, however, not willing to disclose sufficient and appropriate information, then they are not fully utilising the advice that outside directors can provide, given their external experience and knowledge of the industry and other businesses, which are imperative for the objective evaluation of situations affecting the firm.

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Finally, in order for board and subcommittees' members to be effective in their respective oversight role, companies as well as investors need to perceive their role as significant for the proper governance of the company's activities in Malaysia.

# APPENDIX

**Appendix 2A: Malaysia Bourse Securities Limited (MBSB) Listing Requirements,  
(Source: Malaysia Bourse Securities Listing Requirement, (January 2001; December 2006) [www.klse.com.my](http://www.klse.com.my))**

**Chapter 1: Part A Definition**

|                                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|---------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p align="center">Independent Director<br/>(pp 1.04-1.05)</p> | <ul style="list-style-type: none"> <li>• <b>Independence:</b> Independent of management, free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interests of an applicant or a listed issuer. This includes:             <ol style="list-style-type: none"> <li>i. Not being an executive director of the applicant, listed issuer or any related corporation of the applicant and listed issuer;</li> <li>ii. Within the last 2 years has not been an executive officer of the applicant, listed issuer or related corporation (See section 4 of the Companies Act 1964 on ‘officer’)</li> <li>iii. Not being a major shareholder of the applicant, listed issuer or any related corporation of such applicant or listed issuer;</li> <li>iv. Not being a relative of any executive director, officer or major shareholders of the applicant, listed issuer or related corporation of such applicant or listed issuer. Namely ‘relative’ encompasses the spouse, parent, brother, sister, child (including adopted or step child) and the spouse of such brother, sister or child;</li> <li>v. Not acting as a nominee or representative of any executive director or major shareholder of the applicant, listed issuer or any related corporation of such applicant or listed issuer;</li> <li>vi. Is not engaged as a professional adviser by the applicant, listed issuer or any related corporation of such applicant or listed issuer either personally or through a firm or company of which he is a partner, director or major shareholder where applicable; or</li> <li>vii. Has not within the last 2 years and does not engage in any transaction with the applicant, listed issuer or any related corporation of such applicant or listed issuer, whether by himself or with other persons or through a firm or company of which he is a partner, director or major shareholder, as the case may be, the value of which exceeds RM250,000.</li> </ol> </li> </ul> |
| <p align="center">Major Shareholders<br/>(pg. 1.06)</p>       | <ul style="list-style-type: none"> <li>• This represents a person who has an interest or interests in one or more voting shares in a company and the nominal amount of that share or the aggregate of the nominal amounts of those shares where such interest:             <ol style="list-style-type: none"> <li>i. equal to or more than 10% of the aggregate of the nominal amounts of all the voting shares in the company; or</li> <li>ii. equal to or more than 5% of the aggregate of the nominal amounts of all the voting shares in the company where such person is the largest shareholder of the company.</li> </ol> <p>For the purpose of this definition, “interest in shares” shall have the meaning given in section 6A of the Companies Act 1965.</p> </li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

## Appendix 2A: Malaysia Bourse Securities Limited (MBSB) Listing Requirements (Continued...)

### Chapter 3: Admission

|                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|-----------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Issued and Paid-Up Capital<br/>(Part B: Para 3.04)</p> | <ul style="list-style-type: none"> <li>• An applicant seeking a listing on the Main Board must have a minimum issued and paid-up capital of RM60 million comprising ordinary shares of at least RM 0.10 each (<i>previously in 2001 it was RM 1.00 each</i>).</li> <li>• An applicant seeking a listing on the Second Board must have a minimum issued and paid-up capital of RM40 million comprising ordinary shares of at least RM0.10 each (<i>previously in 2001 it was RM 1.00 each</i>).</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <p>Shareholding Spread<br/>(Part B: Para 3.05)</p>        | <ul style="list-style-type: none"> <li>• An applicant must have at least 25% of its issued and paid-up capital in the hands of minimum number of public shareholders holding not less than 1000 shares each whereby companies with nominal value of issued and paid up capital of :             <ol style="list-style-type: none"> <li>i. Between RM 40 million to less than RM 60 million, the minimum number of shareholders required are 750.</li> <li>ii. Between RM 60 million to less than RM 100 million, the minimum number of shareholders required are 1000.</li> <li>iii. RM 100 million and above the minimum number of shareholders required are 1250.</li> </ol> <p>For the purpose of complying with National Development Policy, the 25% spread can encompass up to 5% issued and paid capital of listed issuer held by employees and 10% of the issued and paid up capital of listed issuer held by Bumiputera investors.</p> </li> </ul> |

### Chapter 7: Articles of Association

|                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|--------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Remuneration of Directors<br/>(Part K: Para 7.25)</p>                       | <ul style="list-style-type: none"> <li>• The non executive directors are paid fees of fixed amount and not by a commission on or percentage of profits or turnover</li> <li>• The salaries payable to executive directors exclude commissions on or percentage of turnover</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <p>Election of Directors<br/>(Part K: Para 7.28)</p>                           | <ul style="list-style-type: none"> <li>• An election of directors shall take place each year</li> <li>• All directors shall retire from office once at least in each 3 years, but shall be eligible for re-election</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| <p>Power of Managing Director<br/>(Part K: Para 7.31)</p>                      | <ul style="list-style-type: none"> <li>• A managing director shall be subject to the control of the board of directors</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| <p>Compliance with Shareholding Spread Requirement<br/>(Part E: Para 8.15)</p> | <ul style="list-style-type: none"> <li>• A listed issuer must ensure that at least 25% of its total listed shares are in the hands of a minimum of 1,000 public shareholders holding not less than 100 shares each. The Exchange may accept a percentage lower than 25% of the total number of listed shares if it is satisfied that such lower percentage is sufficient for a liquid market in such shares.</li> <li>• A listed issuer must inform the Exchange immediately if it becomes aware that it does not comply with the required shareholding spread referred to in subparagraph (1).</li> </ul> <p>A listed issuer which fails to maintain the required shareholding spread referred to in subparagraph (1) may request for an extension of time to rectify the situation. Where no extension of time is granted by the Exchange, the Exchange may suspend</p> |

**Appendix 2A: Malaysia Bourse Securities Limited (MBSB) Listing Requirements (Continued...)**

Compliance with Shareholding Spread Requirement (Part E: Para 8.15) (Continued...)

trading in the securities of the listed issuer and/or de-list the listed issuer.

- In the event the spread of shareholdings of a listed issuer is equal to or below 10% of the total number of listed shares, the Exchange may suspend trading in the securities of such listed issuer.
- In relation to a take-over offer for the acquisition of the listed shares of a listed issuer pursuant to the Code as defined under Chapter 11 or corporate proposals undertaken by or in relation to a listed issuer, upon 90% or more of the listed shares of the said listed issuer being held by a shareholder either singly or jointly with associates of the said shareholder, an immediate announcement must be made by the listed issuer. Upon such announcement, all the securities of the listed issuer may be suspended from trading and/or removed from the Official List of the Exchange.
- Notwithstanding subparagraph (5) above, all the securities of the listed issuer shall be removed from the Official List of the Exchange:-
  - (a) in relation to a take-over offer, upon announcement by the listed issuer pursuant to subparagraph (5) above unless the offeror has provided in the offer document:-
    - (i) its intention to maintain the listing status of the listed issuer and not to invoke the provisions under Section 34 of the Securities Commission Act 1993; and
    - (ii) detailed plans, the complete implementation of which would result in full compliance by the listed issuer with all the provisions of the Listing Requirements.
  - (b) in relation to corporate proposals, upon announcement pursuant to subparagraph (5) above that:-
    - (i) 100% of the listed shares of the said listed issuer are held by a shareholder either singly or jointly with the associates of the said shareholder; and
    - (ii) the corporate proposals do not include any plans duly approved by the shareholders of the listed issuer before the proposals were undertaken, the complete implementation of which would result in full compliance by the listed issuer with all the provisions of the Listing Requirements.
- For the purpose of subparagraphs (5) and (6) above:-
  - (i) “corporate proposals” shall include a reverse take-over, a very substantial acquisition or a scheme of compromise, arrangement, amalgamation or reconstruction; and
  - (ii) “associates of the said shareholder” shall have the meaning given in relation to “associates of directors or shareholders” as set out in the definition “public” under paragraph 1.01.
- Unless the context otherwise requires, the words or expressions used in this Part shall have the meanings given under the Section 33 of the Securities Commission Act 1993 and the Malaysian Code on Take-Overs and Mergers 1998.

## Appendix 2A: Malaysia Bourse Securities Limited (MBSB) Listing Requirements (Continued...)

### Chapter 9: Continuing Disclosure

|                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|-----------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Immediate Disclosure of Material Information<br/>(Part C: Para 9.03)</p> | <ul style="list-style-type: none"><li>• A listed issuer must make immediate public disclosure of any material information, except as set out in paragraph 9.05 below.</li><li>• Information is considered material, if it is reasonably expected to have a material effect on:-<ul style="list-style-type: none"><li>(a) the price, value or market activity of any of the listed issuer's securities; or</li><li>(b) the decision of a holder of securities of the listed issuer or an investor in determining his choice of action.</li></ul></li><li>• Without limiting the generality of subparagraph (2) above, material information may include information which:-<ul style="list-style-type: none"><li>(a) concerns the listed issuer's assets and liabilities, business, financial condition or prospects;</li><li>(b) relates to dealings with employees, suppliers, customers and others;</li><li>(c) relates to any event affecting the present or potential dilution of the rights or interests of the listed issuer's securities; or</li><li>(d) relates to any event materially affecting the size of the public holding of its securities.</li></ul></li></ul> |
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