
A Study on the Implication of Independent Directors in
Malaysia

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A Study on the Implications of Independent Directors in
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TABLE OF CONTENTS	
	Page
Copyright Page	iii
Declaration	iv
Acknowledgement	v
Table of Contents	vi
List of Tables	viii
List of Figures	ix
Abstract	x
CHAPTER 1 INTRODUCTION	1
1.1 Background of the Study	1
1.2 Problem Statement	2
1.3 Research Questions	3
1.4 Research Objectives	3
1.5 The Importance of the Study	3
CHAPTER 2 LITERATURE REVIEW	5
2.1 An Overview of the Presence of Independent Directors in Malaysia	5
2.2 Roles and Responsibilities of Independent Directors	9
2.3 Who Qualifies as an Independent Director?	11
2.4 Qualities of Independent Directors	14
2.5 Influence of Board Structure on Company Performance	21
CHAPTER 3 RESEARCH METHOD	29
3.1 Research Design	29
3.2 Variables	32
3.3 Hypotheses	33
3.4 Data Analysis Method	34

CHAPTER 4 RESEARCH RESULTS	38
4.1 Descriptive Statistics of the Sample	38
4.2 Correlations between Board Structure and Company Performance	45
4.3 Regression Model of Board Structure and Company Performance	46
CHAPTER 5 DISCUSSION AND CONCLUSION.....	52
5.1 Summary	52
5.2 Limitations of the Study	56
5.3 Implications of the Study	57
5.4 Recommendations for Future Study	58
References	

LIST OF TABLES

	Page
Table 1: Industry classification of the Main Market listed companies and sample distribution.....	31
Table 2: Descriptive statistics (n=384) of cross section data for board size	39
Table 3: Descriptive statistics (n=384) of cross section data for proportion of independent directors on the board	41
Table 4: Descriptive statistics (n=384) of cross section data for company performance measured by ROA	44
Table 5: Correlations between variables in the model	45
Table 6: Regression model of company performance ^b	47
Table 7: Analysis of variance (ANOVA) on the impact of board structure on company performance	49
Table 8: Regression coefficients of company performance (in ROA measure)..	50

LIST OF FIGURES

	Page
Figure 1: Research design: Influence of the board structure on the company performance.....	32
Figure 2: Research conceptual framework: Independent, dependent variables and hypotheses	33
Figure 3: The trend of the sample median of board size from 2006/2007 to 2010/2011	40
Figure 4: The trend of the sample mean of the proportion of independent directors on the board from 2006/2007 to 2010/2011	42

ABSTRACT

Since the 1997/8 financial crisis that hit Malaysia, Malaysian listed companies are under increasing pressure from the regulators targeting in the reform of the structure of their board of directors to ensure good corporate governance in their entities. To understand the contribution of independent directors, this study reviewed the roles, responsibilities, qualifications and qualities of independent directors and examined their impact on the company performance in terms of board size and proportion of independent directors on the board. A sample of 384 listed companies in the Main Market of Bursa Malaysia was selected covering 7 major sectors namely industrial products, consumer, trading and services, finance, technology, construction, properties and plantation sectors. Cross sectional analyses on descriptive statistics and coefficient of correlation were carried out to assess the yearly trend and the impact of board structure in terms of board size and proportion of independent directors on the performance of the companies across different sectors. Two hypotheses were formed after reviewing the literature and were tested using pooled ordinary least square model. The results found across the sectors mostly supported the first hypothesis that there was a significant relationship between board structure and company performance. However, the results did not support the second hypothesis as it was found that the proportion of independent directors on the board was not associated with the performance of the non-financial companies. The proportion of independent directors on the board was rather significant and negatively associated with the performance of the financial companies. In contrast, the board size appeared to have a significant and positive influence on the performance of the companies in most sectors namely industrial products, consumers, trading and services, technology and properties. These results suggested that larger boards with lesser number of independent directors on the board were more beneficial to company performance.

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

The issue of the importance of the independent directors in promoting good corporate governance has been widely debated in the surveys on the companies in various countries. An independent director is someone, who apart from his fee as a director, has no other pecuniary or material interest in the company or its management, dealings, promoters, subsidiaries or anything else which the company's board of directors [board] find might otherwise impede such a director's judgment (Muhiudeen, 2010). Independent directors are those who are able to give independent judgments and opinions which would benefit the company (Cheah & Lee, 2009) and are essential to enhance the quality of the decision making process of a company. Furthermore, in the survey conducted by McKinsey and the Korean Institute of Directors, the Korean institutional investors mostly agreed that broader disclosure of information and more effective board practices including a more independent board is required in promoting good corporate governance (McKinsey, 2002).

The importance and the intense need for independent directors can be widely seen due to the failures in the systems of various companies. For instance, the collapse of Enron and other major corporations around the world and the recent global financial crisis have most likely shattered the investors' confidence (Solomon, 2007). Further according to Lessing (2009), a fundamental problem exists with the governance of large listed companies due to the division between ownership and control. The danger lies within the directors and managers acting in their own interests rather than those of the shareholders.

In Thailand, Nikomborirak (2001) claimed that the board is often accused of being involved in connected transactions or even fraud and in order to remedy this, the Stock Exchange Commission of Thailand, had passed several rules and regulations to help to promote more effective board's supervision of management which includes the requirement of two independent directors.

In Malaysia on 29 December 2009, the former director of Linear Corporation Berhad was found to have paid out its entire cash hoard of RM36 million without its board approval after the company was awarded a massive RM1.67 billion contract to build a district cooling plant, also known as the "King Dome" project in Manjung Perak (Tee, 2010). Subsequent investigations however revealed that there was no evidence of any significant process towards the execution of the said contract and there was no documentary evidence to demonstrate the overall viability of the King Dome project (Tee, 2010). This had raised the investors' concern over the lack of proper checks and balance of Linear Corporation Berhad's executive directors' powers and the intense need for independent directors to ensure the protection of the minority shareholders' interests. To ensure effective and efficient checks and balance, Malaysian regulators thus emphasised on the importance of having quality independent directors.

Whilst this overview identified a consensus found from the literature on the positive relationship between independent directors and corporate governance, one is led to wonder as to how the individuals serving in this capacity may carry out their duties in an effective manner. Further, there is also a lack of acknowledgement on the implications of the independent directors on the performance of a company as to whether the structure of the board and company performance are positively related in which this study will try to explore.

1.2 Problem Statement

The question now is "what are the implications of the independent directors in Malaysia and whether or not their presence will influence the performance of the Malaysian companies?"

1.3 Research Questions

The proposed study is aimed to address the specific research questions as follow:-

- What is the effect of board structure on the performance of the Malaysian companies?
- Does the proportion of independent directors on the board influence the performance of the Malaysian companies?

1.4 Research Objectives

The main aim of this study is to understand the contribution of independent directors and examined the impact of their presence on the performance of the Malaysian companies. The specific research objectives therefore are:-

- To analyse the effect of board structure on the performance of the Malaysian companies; and
- To examine the influence of the proportion of independent directors on the performance of the Malaysian companies.

1.5 The Importance of the Study

Despite the number of studies conducted in the past which acknowledged the importance of the role of the independent directors in promoting good corporate governance and better company's performance, yet many Malaysian companies engaged independent directors to serve on their boards merely to comply with the requirements of the regulations on companies. This is because the studies on the relationship of proportion of independent directors on the board and company performance in the context of Malaysia had revealed mixed and inconclusive results as well as ignored the underlying differences of the company's operation across different sectors. Two studies concluded that there is no significant relationship between board independence and company

performance (Ponnu, 2008; Shakir, n.d.) while two other studies revealed that the presence of a majority of independent directors on the board is significant and inversely related to the company performance (Mohd Saat, Karbhari, Heravi & Md Nassir, 2011; Chang & Leng as cited in Mashayekhi & Bazaz, 2008).

Building upon these studies in the context of Malaysia, various questions arise. Why do the regulations in Malaysia still require the appointment of independent directors for listed companies as part of building good corporate governance practices when the board comprising of a majority of independent directors will either reduce or will not influence the performance of the companies in Malaysia? What are the required roles and qualities of independent directors? Will the structure of the board in a different industry influence the company performance in a different manner?

Therefore, upon completion of this study, the roles and qualities of the independent directors would be clearly defined and whether the presence of the independent directors in the board would enhance the performance of the companies differently in different sectors, would be revealed. These insights would then be significant contributions to our knowledge of the roles and qualities of the independent directors and whether the presence of independent directors would also contribute differently to the performance of the Malaysian companies in different industry. This shall serve as an important framework condition for the policy makers in reviewing the requirement for the board to suit the condition of a different industry.

To achieve the foregoing purpose, the remainder of this study is segregated into four chapters. Chapter 2 discusses the presence of independent directors and reviews the previous relevant literature and findings of previous research. On the other hand, Chapter 3 discusses the sample data of the study, development of various hypotheses for testing and the method of data analysis. Chapter 4 further provides the findings of the study and discusses the empirical results whereas the discussion and interpretation of the research results as well as the conclusion and recommendations are presented in the final chapter, Chapter 5.

CHAPTER 2

LITERATURE REVIEW

This literature review starts by re-visiting the presence of independent directors in Malaysia. Subsequently, it provides an understanding on the roles and responsibilities of independent directors followed by some of the requirements prescribed in order for them to qualify as independent directors. It also addresses the distinctive qualities that the independent directors should possess in order to effectively contribute to the performance of the companies. The last part of this review will examine whether the differences in board structure influence the performance of the companies.

2.1 An Overview of the Presence of Independent Directors in Malaysia

An independent director is member of the board who does not hold any office in the company, has no management responsibility and has no interest in the company (Goo & Carver, 2003). He is thus someone, who apart from his fee as a director, has no other pecuniary or material interest in the company or its management, dealings, promoters, subsidiaries or anything else which the company's board finds might otherwise impede such a director's judgment (Muhiudeen, 2010).

Independent directors are those who are appointed for their personal and professional qualities, who can perform their roles and responsibilities without being conditioned by the relationships with the company, its significant shareholders and its managers (Stein & Plaza, 2011). They are thus able to give independent judgments and opinions which would benefit the company (Cheah & Lee, 2009) and are essential to enhance the quality of the decision making process of a company.

The importance and the intense need for independent directors can be widely seen due to the failures in the systems of various companies. For instance, when touches on the issue of corporate governance, the collapse of Enron and other major corporations around the world and the recent global financial crisis have most likely shattered the investors' confidence (Solomon, 2007). Further according to Lessing (2009), a fundamental problem exists with the governance of large listed companies due to the division between ownership and control. The danger lies within the directors and managers acting in their own interests rather than those of the shareholders.

As mentioned earlier, in Malaysia on 29 December 2009, the former director of Linear Corporation Berhad was found to have paid out its entire cash hoard of RM36 million without its board approval after the company was awarded a massive RM1.67 billion contract to build a district cooling plant, also known as the "King Dome" project in Manjung Perak (Tee, 2010). Subsequent investigations however revealed that there was no evidence of any significant process towards the execution of the said contract and there was no documentary evidence to demonstrate the overall viability of the King Dome project (Tee, 2010). This had raised the investors' concern over the lack of proper checks and balance of Linear Corporation Berhad's executive directors' powers and the intense need for independent directors to ensure the protection of the minority shareholders' interests.

Meanwhile, it was also reported by Tee (2010) that Axis Incorporation Berhad, a PN17 company, found out that their purchase and delivery orders, bank statements and cheque butts had gone missing which prompted it to make massive write-offs. It was also reported that most of these documents were related to its dealings with questionable contract manufacturers and in mid of 2009, auditors questioned the sharp rise in receivables from contract manufacturers, mainly in Cambodia, from RM11 million in March 2007 to RM105 million in March 2008. The issue however remains as to who the "contract manufacturers" are, and how they were able to walk away with some RM100 million. This again resulted in detailed scrutiny of the effectiveness of their board structure.

In Malaysia, in recognition of the need to enhance the standard of corporate governance following the 1997/8 financial crisis, the High Level Finance Committee was formed in 1998 to establish a framework for corporate governance and setting best practices for the capital market (Cheah & Lee, 2009). This led to the launch of the Malaysian Code on Corporate Governance in March 2000 by the Securities Commission of Malaysia followed by the subsequent releases of the Listing Requirements (now known as the Main Market Listing Requirements) by Bursa Malaysia Securities Berhad [Bursa] and the revised Malaysian Code on Corporate Governance [MCCG] (2007) (Cheah & Lee, 2009). One of the requirements imposed in regulating corporate governance is the appointment of independent directors.

Despite all the past efforts made by the Malaysian regulators acknowledging the importance of the independent directors in promoting good corporate governance and supporting the appointment of independent board, yet many listed companies engage independent directors to serve on their boards mainly because of the recommendations made by the MCCG (2007) and also to fulfill the Main Market Listing Requirements particularly as stated in Paragraph 15.02 of the Main Market Listing Requirements of Bursa to have at least two independent directors in the board or one third of the board to be consisting of independent directors. As mentioned, these companies may not appreciate the importance of independent directors as a mean to enhance corporate governance which is believed will in turn lead to better company performance.

In the Asian countries, the acceptance of the presence and appointment of independent directors is mixed, some countries are lacking while others are encouraging. For instance, the survey of the companies listed on the Stock Exchange of Thailand as conducted by the Price Waterhouse Management Consultants Limited in year 1998 revealed that only fifteen percent of the companies surveyed believed that the appointment of independent directors contributed great value to their companies (as cited by Nikomborirak, 2001). In Japan, despite the amendments to the Commercial Code in 2001, which limited the responsibilities of the independent directors and resulted in the increase of the number of companies appointing independent directors, the appointment of independent directors however has not become as common a practice as expected

and approximately half of the listed companies in Japan do not have independent directors, and their boards are comprised solely of internally appointed directors (Saito, 2009). Similarly in China, only approximately five percent of listed companies engaged independent director as of end of 2000 (Ho & Xu, 2002).

In Malaysia, a verification conducted on Malaysia's top 30 public-listed companies, which formed the benchmark of the Federal Territory Stock Exchange (FTSE) of Bursa Malaysia Kuala Lumpur Composite Index (KLCI) in year 2009 however revealed that 18 of them or 60 percent of Malaysian largest companies had at least half of their boardroom's seats filled with independent directors (Yeap, 2009). In a study conducted by a Melbourne-based corporate governance consultancy, Institutional Analysis on the Top 100 Australian Companies (ranked by market capitalisation) for the year 2000, on average, their boards comprised of 22 percent of executive directors and the other 78 percent were held by non-executive directors (as cited in Baxt, Ramsay & Stapledon, 2002). In the United States, the average board size for all the companies is 10, with 8 being independent (Solomon, 2007).

However, having boards dominated by independent directors does not necessarily assure good corporate governance. According to Shireen Ann Zaharah Muhiudeen, the managing director of a fund management company, Corston-Smith Asset Management Sdn Bhd that invests in listed companies in Asian countries which exhibit transparent corporate governance practices, Malaysian independent directors may not be really independent and competent enough to assist in effective decision making even though most of the Malaysian listed companies have fulfilled the Main Market Listing Requirements of having at least one third of the board occupied by independent directors (as cited in Chong, 2009). Most of the time, the appointed independent directors were not truly independent because they were found to be affiliated with the management and/or they lack the necessary qualities expected to serve on the board. As stated by Tan Sri Ramon Navaratnam, the outspoken Transparency International Malaysia's former president acknowledged and said that, *"we may have the numbers (independent directors), but numbers don't necessarily translate into quality or calibre...then there is the question of whether some directors have been too long*

on the board to continue being independent” (as cited in The Edge Malaysia, 2009b).

2.2 Roles and Responsibilities of Independent Directors

As a first line of protection, the law imposes various duties on directors which include fiduciary duties such as the duty to act fairly and honestly and the duty of care (Lessing, 2009). The provisions relating to fiduciary duties of directors of companies are contained in Section 132 of the Companies Act 1965 in which it expresses that “*a director of a company shall at all times exercise his powers for a proper purpose and in good faith in the best interest of the company*”(as cited in Companies Act, 2009, p. 145). Such definition entails that directors have two major duties namely duty to act for a proper purpose and duty to act in the best interests of the company. They are therefore liable under the law should they be in breach of their duty. A series of instances as to what constitutes a breach of the duty are further mentioned in Section 132 of the Companies Act 1965 which carries a maximum five years’ jail or a fine of RM30,000.00 or both (Jayaseelan, Tee & Tan, 2010). Besides, the recent enforcement of the new Section 317A of the Capital Market and Services Act 2007 also empowers the Securities Commission to prosecute directors for breaching their fiduciary duties (Jayaseelan et al., 2010).

Legally, independent directors are exposed to the same legal duties although they have less control over the management of the company as compared to executive directors (Chia & Phua, 2009). As pointed out by John Lim, the President of the Singapore Institute of Directors, an independent director is just like any other director, is duty and legally bounded, to act in the interest of the company as a whole (as cited in Kwok, 2007).

Independent directors are today regarded as an important mechanism of good corporate governance. The Cadbury Report in the United Kingdom, an earlier code of best practices on the role of non-executive directors and on the independence which such individuals were required to possess, envisaged that there are two main areas where non-executive directors could contribute to corporate governance process due to their independence namely reviewing the

performance of the board and of the executive directors and resolving potential conflict of interests particularly in relation to directors' remuneration (as cited in Ho & Xu, 2002).

In a survey of a large sample of investment institutions conducted by Solomon (2007), the respondents ranked the presence of independent directors on the boards as the most essential corporate governance mechanism recommended in successive policy documents. Their primary role is to act as an independent monitor of the management and to protect the interests of shareholders (Lessing, 2009). They are perceived as the designated watchdogs of the company and are expected to represent the interests of a usually diverse group of shareholders particularly minority shareholders and to provide regular checks and balances (Chia & Phua, 2009).

In addition, Cheah and Lee (2009) stated that in most jurisdictions, independent non-executive directors may contribute effectively on corporate governance by playing a dual role of providing independent business judgment, advice and assistance to support the executive team as well as ensuring that the interest of investors and other stakeholders are being protected. Their responsibilities shall also include monitoring and contributing effectively to the approach and performance of the management, staffing key committees of the board, and influencing the function of the board as a whole (Low, 2002).

Independent directors are supposed to be able to exercise sound judgment on corporate affairs independently which is especially critical in the areas when the interests of management, the company and shareholders may differ (Kwok, 2007). As suggested in the Corporate Governance Committee's Report 2001, these areas of judgment shall cover successive planning, change of corporate control and audit function, executive remuneration, as well as the objective evaluation of the board and management performance (as cited in Kwok, 2007).

In contrast, Zandstra (2007) viewed that independent directors are not the assurance of good corporate governance and that the key sound governance is the independence of judgment. Cheah and Lee (2009) further referred to the Higgs Report and stated that independent directors need to be sound in judgment, to have an inquiring mind and should be able to question intelligently, debate

constructively, challenge rigorously and decide dispassionately besides to listen sensitively to the views of others, inside and outside the board.

Basically, independent directors are appointed to the board but they do not have executive powers and do not run the company's day-to-day operation. Instead, they sit on the board to provide an independent judgment on issues of the company's strategy, performance and resources, including key appointments and standards of conduct and are often involved in the crucial aspects of a company's responsibilities (Bushon, 2010). Notwithstanding that, independent directors who exercise their best judgment must not be clouded by any conflicts of interest, whether real or perceived (Bushon, 2010).

The role of an independent director is summarised by Zandstra (2007) as follow:-

- To offer specialist skills;
- To add variety to the board and eliminate the culture of a unitary board;
- To provide an independent review – separation of ownership and control;
- To exploit corporate experience and leadership qualities;
- To offer expertise, explicitly to support the Chief Executive Officer (CEO);
- To show credibility to governance model; and
- To act as chair – provide leadership and vision.

2.3 Who Qualifies as an Independent Director?

Bursa (2009) defines an independent director in Paragraph 1.01 of the Main Market Listing Requirements and Practice Note No. 13/2009 as one:-

- (a) who is not an executive director;
- (b) is not and has not been, within the last two years, an officer of the company (except as a non-executive director);

-
- (c) is not a major shareholder of the company;
 - (d) is not a family member of any executive director, officer or major shareholder of the company;
 - (e) is not acting as a nominee or representative of any executive director or major shareholder of the company;
 - (f) has not been engaged as an advisor of the company under such circumstances as prescribed by Bursa or is not at present a partner, director (except as an independent director) or major shareholder, as the case may be, of a firm or corporation which provides professional advisory services to the company under such circumstances as prescribed by Bursa; and
 - (g) has not engaged in any transaction with the company under such circumstances as prescribed by Bursa or is not at present a partner, director or major shareholder, as the case may be, of the company (other than subsidiaries or the applicant or listed issuers) which has engaged in any transaction with the company under such circumstances as prescribed by Bursa.

In addition, Paragraph 4 of Practice Note 13/2009 of the Bursa (2009) further clarifies that a director shall be disqualified from being an independent director if he has personally provided professional advisory services to the company within the last two years or is presently a partner, director (except as an independent director) or major shareholder of the company that has provided professional advisory services to the said company within the last two years, the consideration of which in aggregate exceeds five percent of the gross revenue of the said Director of the Entity or RM 1 million, whichever is the higher.

The comprehensive definition spelt out in Bursa (2009) is adequate to deduce that a qualified independent director must not be personally related to the company and must not be engaged in some business with the company within the last two years. In addition, Bursa (2009) also restricts a director including the independent director of a company to hold not more than 25 directorships in companies of which the number of directorship must not be more than 10 in listed companies and not more than 15 in non-listed companies as stated in Paragraph

15.06 of its Main Market Listing Requirements. However, Bushon (2010) is of a differing view that a candidate who qualifies for the position of independent director should not hold more than five directorships in listed companies rather than the maximum of ten directorships as imposed by Bursa (2009). Nonetheless, the purpose of having the restriction and recommendation on the number of directorships is to ensure that all directors including independent directors are devoted adequately to their roles and responsibilities required of them.

Although Bursa (2009) had addressed the various criteria of an independent director in its listing requirements, it does not warrant that a person appointed as an independent director can contribute to good corporate governance and better corporate performance. As such, the Minority Shareholder Watchdog Group (MSWG) which represents large number of shareholders has been actively monitoring annual general meetings (AGMs) for breaches and non-compliance in corporate governance practices by listed companies (Cheah & Lee, 2009) as well as looking into the process of appointing independent directors (Bushon, 2009). In this regard, MSWG has formed a pool of independent directors for companies to select the ideal candidates to become their independent directors.

To be a qualified potential independent director registered in MSWG's pool for the companies to tap, MSWG requires the candidate to be from a professional body or have long experience in senior managerial positions (Bushon, 2010). MSWG viewed that independent directors should be appointed from people with the requisite skills, credibility and experience to make independent judgments on issues of strategy and performance (as cited in Bushon, 2009). In view of the collapse of Enron and failures of the financial system of Malaysian companies as reviewed earlier, it is crucial to have independent directors who are able to understand complex financial instruments to enable them to make rational decision (The Edge Malaysia, 2009b). Financial knowledge must now become an important prerequisite for independent directors because they are mostly members of the audit committee (Bushon, 2009). However, verification conducted on Malaysia's top thirty public-listed companies which formed the benchmark of Federal Territory Stock Exchange Bursa Malaysia Kuala Lumpur Composite Index shows that none of the independent directors are equipped with the essential

financial background although most of them have vast managerial experiences (The Edge Malaysia, 2009b).

Apart from that, MSWG has also put in an age criteria for more matured candidates namely those above 40 years (Minority Shareholder Watchdog Group, 2009). A closer look into the age of the independent directors of Malaysia's top thirty public-listed companies reveals that only 10 directors or 8% of the independent directors are aged below 50, around 42% of them are between 61 and 70 and one-fifth are above 70 (The Edge Malaysia, 2009b). Such finding demonstrates that the largest Malaysian companies very much complied with the age requirement reckoned by MSWG.

Furthermore, in making the appointment of an independent director, Cheah and Lee (2009) stated that the board should draw on a wide pool of talent rather than known contacts of the chairman, CEO or other board members. They added that the board should also consider its present composition and whether it would benefit from having more female directors or directors from an ethnic minority background. They must also have adequate time to devote to their role and responsibilities. After all, corporate governance is not merely about having qualified independent directors to comply with the various criteria as set out in the regulations. More importantly, it is to fill up the post of the independent directors with people of the requisite qualities to discharge their roles and responsibilities required of them if the companies really want to promote good corporate governance and to achieve improved company performance.

2.4 Qualities of Independent Directors

Tan Sri Ramon Navaratnam, the outspoken Transparency International Malaysia's former president once said, "*Independence alone is no longer enough. Do we [our boardrooms] have the quality? Do all the independent directors have the skillsets and experience to make a thorough assessment?*" (as cited in The Edge Malaysia, 2009b)

The CEO of MSWG, Rita Benoy Bushon is also of the view that it is crucial that an independent director possesses a diverse and in-depth skill-set relevant to the company's businesses which adequately represents all the

company's stakeholders (Bushon, 2010). He needs to have a clear understanding of formal governance structures and policies with a strong knowledge of the business which he is responsible for directing and guiding and also be aware of any changes in the accounting, regulatory and business environment that the companies operate in (Kwok, 2007).

Pursuant to Best Practices Provision AA VIII in Part 2 of the MCCG (2007), the appointment of directors to the board including independent directors should be recommended by the nominating committee consisting of a majority of independent directors. Under the same paragraph, the MCCG (2007) also proposes to the nominating committee to make recommendation of new nominees of directors to the board by considering the candidates' qualities in terms of skills, knowledge, expertise and experience, professionalism, integrity, ability to discharge responsibilities in the case of candidates for positions of independent non-executive directors and to consider on the candidates proposed by the CEO, senior executive or any director or shareholder. The effectiveness of the board should also be reviewed annually assessing the required mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board as stated under the Best Practices Provision AA IX in Part 2 of the MCCG (2007).

Further, under Paragraph 15.08 of the Main Market Listing Requirements established by Bursa (2009), it is mandatory for every director including an independent director to attend appropriate training programmes as prescribed by Bursa Malaysia from time to time. Similarly, the MCCG 2007 requires every director to attend appropriate training comprising an appreciation of director's duties as well as the manner in which these duties are to be discharged when he or she is first appointed to the board and also further suggests every director to receive continuing professional training especially on relevant new laws, regulations and changing commercial risks (Dato Megat Najimuddin Khas, Low & Anandarajah, 2002). In essence, the recommendations from both the MCCG (2007) and the Main Market Listing Requirements of Bursa (2009) are to have a board which consists of directors who are competent and possess the necessary qualities to perform their role and responsibilities effectively.

Apart from the qualities identified by the MCCG (2007) and Bursa (2009), Kwok (2007) have identified several qualities and attributes where an independent director should possess as follow:-

- integrity and common sense;
- must believe in doing the right and/or best thing for the company above self-interest;
- good communication and analytical skills;
- ability to provide informed business judgment;
- genuinely open to the opinions of others;
- strong independent mindset to maintain a balanced viewpoint; and
- an enquiring, probing mind.

Similarly, Stein and Plaza (2011) also acknowledged that an independent director must be loyal in carrying out all activities that may be required to achieve the company's goals, diligence to effectively devote the necessary time and effort to carry out the duties given to him and have professional reputation to contribute a series of knowledge and skills to the board to give added value to the board's work.

In view of the importance of the qualities should an independent director possess to boost corporate governance, Bursa Malaysia recently enforced new amendments to its Main Market Listing Requirements on 3rd January 2012. The new amendment is stated under Paragraph 2.20A of the Main Market's Listing Requirements as follows:-

“Every listed corporation must ensure that each of its directors, CEOs or CFOs has the character, experience, integrity, competence and time to effectively discharge his role as a director, CEO or CFO as the case may be, of the listed corporation”(as cited in Oh, 2011, p.3).

In such instance, Bursa Malaysia will now have the power to direct a company to change board members including independent directors, chief executive officer (CEOs) and chief financial officers (CFOs) if the board members

have not demonstrated the “character, experience, integrity, competence and time” to carry out their roles (Oh, 2011).

Building from these qualities of a director as compulsorily required under the Main Market Listing Requirements of Bursa, the remaining of this section will discuss in depth on the specific qualities that an independent director must possess which are categorised into independent character, experience and competency, integrity as well as time commitment.

2.4.1 Independent character

Unlike an executive director, it is essential that an independent director should not be involved in the management and is not an employee of the company and does not exercise control (Chia & Phua, 2009). Studies have identified that the contribution of independent directors on corporate governance significantly depends on whether they are independent or had link with management. The problem in the past has been that many of them had some affiliation with the management and allowed these to compromise their independence (Lessing, 2009).

According to Goo and Carver (2003), the independent directors are usually appointed by the Chairman who is usually the controlling shareholder and therefore it becomes an obstacle to the effectiveness of independent directors. There are also possibilities that the independent directors may not be truly independent as they may have a personal relationship with the CEO (Bhagat & Black, 2000). As questioned by Bushon (2009), *“can we expect the independent directors to be totally impartial in their views when their appointment or tenure is pretty much in the hands of the major shareholders?”* When most of the decisions made by the Chairman are fully supported by his own appointed independent directors without doubts, this will outvote other executive directors’ opinions in the board meeting and jeopardise the corporate governance.

More often than not, some of these independent directors have close relationship with the management or major shareholders are appointed as independent directors and in some other cases, the independent directors stay on too long in the company and become affiliated to the major shareholder or the management (Siow, 2009). MSWG is also of the same view that giving

independent directors excessively long tenures could affect their independence (as cited in Bushon, 2009).

In a speech presented by associate professor Mak Yuen Teen, the co-director of Corporate Governance & Financial Reporting Centre at the National University of Singapore, during the Securities Commission – Bursa Malaysia Corporate Governance Week 2009, he acknowledged that while there were no rules on the maximum period to sit on the board in Malaysia, the corporate governance codes in the United Kingdom barred independent directors to sit longer than nine years (as cited in The Edge Malaysia, 2009a). In China, on the other hand, the Chinese Securities Regulatory Commission (CSRC) regulates that independent directors shall only be appointed up to a maximum tenure of six years in its Guideline to Implementing the Independent Directors System in Listed Companies released on 22nd August 2001 (as cited in Ho & Xu, 2002). Since it will take some time for the newly appointed directors to understand the company's business and operation before they can subsequently enhance the company performance (Yermack as cited in Mohd Saat et al., 2011), the maximum period to sit on the board must neither be too short nor too long and must take into consideration the learning curve of any person. Mak (as cited in the Edge Malaysia, 2009a) was of the view that after an independent director sits for nine years, it would be good to let others to join the company in order to take a fresh look at it as well as to avoid the issue of becoming affiliated with major shareholder or management.

By having no affiliation with the management and major shareholder, independent director should be able to give a truly independent and impartial opinion for the benefit of the company (Stein & Plaza, 2011).

2.4.2 Experience and Competency

In addition to the fiduciary duties of directors mentioned earlier, Section 132 (1A) of the Companies Act 1965 expresses as follows:-

“A director of a company shall exercise reasonable care, skill and diligence with:

(a) the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and

(b) any additional knowledge, skill and experience which the director in fact has.” (as cited in Companies Act, 2009, p. 145)

Such statement means that a director is legally required to be competent with the necessary knowledge and skill and possess the experience related to his responsibilities. Should he or she have additional knowledge, skill and experience, he or she is also legally required to apply the additional qualities in the context of his duties of a director.

According to Kwok (2007), a balanced board should have directors, including independent directors who have a complementary mix of skills and expertise. He further added that the board may not necessarily be dominated by accountants or lawyers, or any other professionals but they must be suitably competent to contribute valuable opinion to the board decision making process.

A study by Lee, Rosenstein and Wyatt (as cited in Mohd Saat et al., 2011) however found that independent directors who have financial background and possess specific financial experience namely, commercial banking, insurance and investment management experience, have positive influence on the company performance. Reflecting the importance of director having financial experience in the board, a listed company must now announce the appointment of its CFO in another new addition to the Main Market's Listing Requirements of Bursa Malaysia (Oh, 2011).

Nonetheless, a board mixed with financial, legal and industry experienced people by the major ethnic groups and balanced by gender and other minority representation with the relevant knowledge and skills was however viewed to be the optimal combination by Bushon (2010) in order to have positive impact on company performance.

2.4.3 Integrity

Cheah and Lee (2009) further added that independent directors must avoid themselves from being “rubber stamps” in order to avoid the risk of having no real

discussion on other strategic and alternative options to achieve the company's goals.

When it comes to related party transactions, independent directors must act honestly to vet them carefully to ensure that money invested by public shareholders is not being “upstreamed” or siphoned off to the advantage of themselves or of the controlling shareholder and at a minimum level, they must be able to understand the make-up of the revenues and costs in the profit and loss account and be able to ask probing questions when the ratios show early signs of eroding profitability (Zinkin, 2010).

Independent directors must not be spared effort in obtaining the information he needs and, if they consider it appropriate, they should not hesitate to ask for any opinion he considers appropriate (Stein & Plaza, 2011). They must have a strong mind and character and are not afraid to speak up, question, debate and challenge constructively without fear or favour to act in the interest of all shareholders and at the same time, be wary against practices that may jeopardise the interest of minority stakeholders (Bushon, 2009).

After all, the main goal is to gather the right and/or best information available so that their opinion given can be truly honest and independent.

2.4.4 Time Commitment

Time commitment by independent directors is another important factor to ensure effective contribution of corporate governance. A diligent independent director must be actively involved in the board saying whatever he considers to be the best and necessary for the benefit of the company (Stein & Plaza, 2011). In a survey conducted by KPMG about the performance of independent directors in selected corporations in the United Kingdom, it was recommended that an independent director should allocate sufficient time to the company and attend board meetings regularly (as cited in Gupta, Hothi & Gupta, 2011). Cheah and Lee (2009) further added that although it is important that independent directors must have the necessary time to devote to their role and attend board meetings, they must also be prepared for such meetings and kept themselves updated with the company's business as well as to attend the company's functions.

They also a need to press upon the management the need to provide information within adequate time so that there is sufficient time to carefully study the materials provided and make all necessary enquiries of management and executives (Kwok, 2007). Zinkin (2010) also agreed that independent directors should devote enough time to the company and viewed it as an important element to help them to familiarise themselves with the changing nature of the company's business and environment.

2.5 Influence of Board Structure on Company Performance

Generally, board size and board composition form the structure of the board and differ across companies in different industry. Typically, board structure consists of two types of directors, namely executive directors and independent directors with various skills from varied background (Ponnu, 2008). In order for a company to perform effectively and efficiently, it is essential that the board comprise of the right mix of board members and it is necessary that no single individual board member possesses unfettered power which may dominate the rest of the board members (Cheah & Lee, 2009). Further, boards should also include a sufficient number of independent directors with the relevant capabilities (Low, 2002).

In Malaysia, MCCG 2007 views the composition of the board of a listed company as one of the most crucial channel through which effective corporate governance is ensured (Dato Megat Najmuddin Khas et. al., 2002). To this end, the Principles Provision A I in Part 1 of the MCCG (2007) suggests that every listed company should be headed by an effective board which should lead and control the organisation. To be effective, the Principles Provision A II in Part 1 of the MCCG (2007) proposes the following:-

“The Board should include a balance of executive directors and non executive directors (including independent non-executives directors) such that no individual or small group of individuals can dominate the Board’s decision making”.

In this regard, Best Practices Provision AA III in Part 2 of the MCCG (2007) recommended that independent non-executive directors should make up at

least one-third (1/3) of the board membership. This is to ensure that the independent directors can adequately fulfill their responsibilities in bringing their independent judgment to the board.

2.5.1 Board Size

Does the board size relate to the company performance? According to Goyal (n.d.), the size of the board is influenced by a trade-off between the amount of information required for monitoring and advisory function against increased coordination costs and free-rider problems associated with larger board. This implies that the board size is definitely related to the company performance.

In Malaysia, the Best Practices Provision AA XII in Part 2 of the MCCG (2007) reckons that every board should assess its size in order to determine the influence of the number upon its effectiveness. In an effort to ensure the effectiveness of the board, Bursa (2009) imposes restriction on the board size of listed companies which shall not be more than 10 as stated in Paragraph 15.06 of its Main Market Listing Requirements. Within the same paragraph also, the board size of non-listed companies is meanwhile restricted by Bursa (2009) to a maximum of 15.

Numerous literatures on the relationship between board size and company performance have been extensively reviewed in the past. However, the findings are inconclusive. Most of the literatures find that company performance is negatively related to board size. In other words, smaller boards are more effective than large boards (Goyal, n.d.). This is because group often communicate less effectively beyond a certain size and larger board will thus inhibit board performance and in turn company performance (Jensen as cited in Bohren & Odegaard, 2005).

Following the above argument, extensive empirical studies were conducted to test the relationship between board size and company performance. A number of earlier studies had reported an inverse relationship between board size and firm performance. For instance, using a sample of 452 large US industrial companies between 1984 and 1991, Yermak (as cited in Shakir, n.d.) consistently found that a negative relationship exist between board size and company performance represented by Tobin's Q and return of assets (ROA). Following Yermak's

finding, Bhagat and Black (2000) also found negative and significant association between the board size and the company performance measured by ratio of sales to assets in large US public listed companies. Similarly, Panasian, Prevost and Bhabra (n.d.) and Shakir (n.d.) found that board size is negatively and significant associated with company performance measured by Tobin's Q among the 300 largest Canadian companies by market capitalisation listed on the Toronto Stock Exchange in 1995 and using a sample of 81 companies listed in the property sector on the main board of Bursa Malaysia which is formerly known as Kuala Lumpur Stock Exchange in the period of 1999 to 2005 respectively. Besides, studies from both Hermalin and Weisbach (2003) and Eisenberg, Sundgren and Wells (as cited in Shakir, n.d.) argued that larger boards are less effective than smaller boards and conclude that companies with smaller board size perform better than firms with large board size. With respect to the recent studies, negative associations between board size and company performance were also concluded by Bohren and Odegaard (2005), Mashayekhi and Bazaz (2008) and Rashid, De Zoysa, Lodh and Rudkin (2010) in the different studies conducted on selected non-financial firms listed in the Oslo Stock Exchange (OSE) during the period 1989 to 1997, the Tehran Stock Exchange (TSE) for the years 2005 to 2006 and the Dhaka Stock Exchange during the period from 2005 to 2009 respectively.

Despite a tremendous amount of past studies reveal that the board size and firm performance are inversely related, Kiel and Nicholson (2003), on the other hand, found that, after controlling the firm size, board size is positively correlated with firm performance. Chang and Leng (as cited in Mashayekhi & Bazaz, 2008) also found that the board size have a positive impact on company performance among Malaysian companies. However, Dalton, et al. (as cited in Kiel & Nicholson, 2003) argued that it is not the size of the board, per se, that is critical, but rather the number of independent directors on the board. Further, a study on the US banking industry by Adam and Mehran (as cited in Shakir, n.d.) also reveals a positive relationship between the board size and performance of the financial companies measured by Tobin's Q. In addition, Ma and Tian (2009) also found that company performance will be enhanced when board size increases, but only insignificantly. All these results seem to be inconsistent with the findings of Bohren and Odegaard (2005), Mashayekhi and Bazaz (2008) and Rashid, De

Zoysa, Lodh and Rudkin (2010) in the non-financial companies as reviewed earlier.

In comparison, the number of past empirical studies and literatures suggesting that board size has a negative effect on company performance outweighs the number of findings of a positive relationship between board size and company performance. This study thus would not consider board size as a significant factor influencing company performance for further testing.

2.5.2 Proportion of Independent Directors on the Board

Generally, the importance of having independent directors on the board for effective monitoring management has always been emphasised. Almost every study on the topic finds that a board with the presence of independent directors can have a positive impact on corporate governance (Solomon, 2007). Nevertheless, does the proportion of independent directors on the board make a difference to company performance? Past researchers differ in their views as to whether the proportion of independent directors on the board and the performance of the company are positively related.

A number of theories have been used in explaining the relationship between corporate governance practices and company performance. The most recognised one is agency theory which originated from a thesis prepared in 1932 by Berle and Means entitled “The Modern Corporation and Private Property” (Shakir, n.d.). In essence, agency theory identifies the governance relationship as an agreement between shareholder as the owner and director as the agent (Tricker, 2009). The directors as the agents who have control of the companies may not always act solely in the interest of the shareholders and may be influenced by self-interest which may detriment the welfare of the shareholders which they represent (Paul, Friday & Godwin, 2011). Following this line of reasoning, it is argued that the boards are more effective when represented with a majority of independent directors to protect the interests of their shareholders which in turn improved the performance of the companies. Such argument is further supported by Panasian et al. (n.d.) as they found that the board structure of the top 300 Canadian companies with a majority of independent directors are positively related to the performance of these companies and further suggest that increasing the proportion of

independent directors on the board will reap more benefits for companies that are most likely to have agency problems.

In a study by Core, Holthausen and Larcker (as cited in Solomon, 2007), it has been proven that companies in the United States with weaker corporate governance structures perform less well than companies with better corporate governance structures. Pearce II and Zahra (as cited in Ezzamel & Watson, 2005) also reported that boards with higher representation of independent directors are associated with better financial performance compared to those with a smaller proportion of independent directors on the board. In another study which focuses on non-financial companies listed on the Shanghai and Shenzhen stock exchanges in 2003 and 2004, Ma and Tian (2009) found that company performance is positively and significantly related to the number of independent directors and also the proportion of independent directors on the board.

Further, it is also reported that poor corporate governance mechanism in Organisation for Economic Co-operation and Development [OECD] countries is a major impediment to enhance corporate performance and the competitiveness of firms (Maher & Andersson, 1999). Goo and Carver (2003) are also in agreement that good corporate governance improves corporate performance and further recommended that the board should assign a sufficient number of independent directors capable of making independent judgment on certain tasks where there is a potential for conflict of interest.

According to 2002 Global Investor Opinion Survey of Corporate Governance conducted by McKinsey (2002), global institutional investors are willing to pay an average of 22 percent premium for stocks of companies with good corporate governance practices which have a majority of independent directors. Such a survey implied that boards with a majority of independent directors will attract more investors but did not provide any implication as to whether the companies with a majority of independent directors are better in term of their performance. However just recently, such implication is supported by a research conducted using the data for the year 2010 of 91 sampled companies listed on Karachi Stock Exchange by Khan and Awan (2012) in which they concluded that the companies with their boards heavily occupied by independent

directors will show greater company performance in the forms of return on assets, return on equity and Tobin's Q.

Lawrence and Stapledon (as cited in Kiel & Nicholson, 2003) also found only scattered non-robust correlations between a range of performance measures and the proportion of independent directors on the board. Rhoades, Rechner and Sundaramurthy (as cited in Kiel & Nicholson, 2003) on the other hand also found only a small positive relationship between board independence and financial performance.

On the other hand, there are also some evidences suggesting that independent directors have or may have a negative impact on company performance. In contrast to the agency theory, the stewardship theory adopts more optimistic view of humans (Paul et al., 2011). Stewardship theory believes that directors may not always act in a way that maximise their own interests but do act as stewards of the shareholders' (owners) interest (Tricker, 2009). This implies that executive directors are better than independent directors as they abide by the legislation and legal duty to protect shareholders' interest which will enhance company performance. Nikomborirak (2001) further added that independent directors are often not familiar with the management of the company and will have to rely on executive directors and the management for information and thus their decisions though impartial, well intentioned and independent, may not necessarily lead the company to better performance.

Empirical evidence on the negative relationship between the proportion of independent directors on the board and the company performance is rather scarce. Postma, Ees and Sterken (n.d.) have evaluated such issue using a cross sectional data for the year 1996 on 94 listed non-financial (mainly manufacturing) companies in Amsterdam Stock Exchange and found evidence for a negative association of number and proportion of independent directors on the board with company performance. Negative impact on company performance is supported by Chang and Leng (as cited in Mashayekhi & Bazaz, 2008) given that they found board independence to be negatively correlated with company operating performance.

Further, Agrawal and Knoeber (as cited in Solomon, 2007) found consistent evidence of a negative relationship between the composition of independent directors and the financial performance of the companies. Although they acknowledged that the independent directors were often appointed when the companies perform badly to improve the company's overall performance, they are however unlikely to agree to the hypothesis that higher composition of independent directors in the board improves the financial performance of a company. Mohd Saat et al. (2011) also found a significant negative relationship between the presence of more than a majority independent director on the board and company performance.

In contrast to all the foregoing studies, there is also a stream of research which has failed to show a relationship between the proportion of independent directors on the board and company performance. Having studied using data from a database of 934 large US companies in 1991, Bhagat and Black (2000) claimed that there is no evidence that greater board independence does improve or reduce company performance and they are thus unrelated. Ponnu (2008) conducted a research using one hundred non-financial Malaysian companies as sample data revealed that there is no significant relationship between the proportion of independent directors on the board and company performance. A study of a sample consisting of thirty eight number of companies in Nigeria during the 2009 financial year by Paul et al. (2011) also concluded that there is no significant relationship between the percentage of the board member constituted of the independent directors and corporate performance and an organisation cannot improve its economic performance by raising the independent directors on its board. Sakawa, Watanabel and Ben-Zion (2009) also found no significant relation between the independent directors' ratio and company performance using a sample comprising data of 522 manufacturing companies listed in Tokyo Stock Exchange during 1991-1995.

Similarly, a non-significant link between the proportion of independent directors on the board and company performance was also found in most of the earlier studies in the United States and Australia (Baxt et al., 2002). Dalton, Daily, Ellstrand and Johnson (1998) found that there is no relationship between board composition and company performance while Hermalin and Weisbach (2003)

summarised that higher proportions of independent directors are not associated with greater firm performance, but are associated with the quality of decisions on CEO replacement, responses to a hostile and potential takeover, and the design of CEO compensation schemes. Worse still, after examined the relationships between board demographics and corporate performance among 348 Australia's largest public listed companies, Kiel and Nicholson (2003) found that there is a positive relationship between the proportion of executive directors (not independent directors indeed) and the market-based measure of firm performance. Using the sample of 81 number of listed property companies in Bursa earlier, Shakir (n.d.) also reported the same findings that the percentage of executive directors has a positive effect on company performance measured by Tobin's Q.

Overall, past researchers had put forward differing views as to whether or not there is a positive relationship between the proportion of independent directors on the board and the company performance. Building on the idea that companies with higher proportion of independent directors on the board are likely to do better financially than others which are less committed to such corporate governance practice, the present study is thus established with the belief that higher proportion of independent directors on the board will contribute positively to the performance of the companies of various industries in Malaysia.

If the presence of independent directors on the board has positive impact on the performance of the Malaysian companies, further research could then be conducted to study on how these independent directors can effectively contribute to company performance. The following chapter will discuss the methodology and definitions of variables for further analysis.

CHAPTER 3

RESEARCH METHOD

Research design according to Hair, Money, Samouel, and Page (2007) can be grouped into one of three categories namely exploratory, descriptive and causal design. An exploratory research is most often adopted when the research questions are vague or when there is insufficient theory to guide the predictions whereas a descriptive research often involves providing measures of the characteristics described in the research questions using descriptive statistics. Causal research on the other hand is intended to test whether one event causes another.

This study is a combination of descriptive and exploratory study whereby the researcher chooses to use document analysis of the annual reports and financial database to meet the research purpose of examining the influence of the board composition on the performance of the companies.

3.1 Research Design

The targeted sample population is the Malaysian companies listed on the Main Board of the Bursa from various sectors excluding the public listed companies that are classified as Practice Note 17 (PN17). These PN17 companies seek protection of the court from creditors while going through the corporate restructuring. The financial performances of PN17 companies are thus subject to many irrelevant factors while undergoing the corporate restructuring, and will not accurately establish a board composition versus financial performance relationship. These PN17 companies are, therefore, excluded for the purpose of this study.

Given that the matured companies might have significant different business practices than new companies which could affect their financial data to be significantly different, this study thus focuses only on matured companies.

Arbitrarily, public listed companies that are established at least three years before 2006 are considered mature. Thus, companies which are listed on and after 2003 are excluded in the sample. Besides, as suggested by Adam and Mehran (as cited in Shakir, n.d.), the performance relationship may be industry specific, it is thus inappropriate to explore the relationship of the board structure and company performance because there are likely to be many differences between different types of companies. This study therefore differs from most of the prior studies because it provides a cross sectional analysis on the impact of independent directors on the performance of the various types of the companies. To ensure that the sample size is fairly consistent, the sampled companies are selected according to the sector they are listed on based on stratified sampling (probability sampling). Subsequently, simple random sampling (probability sampling) is carried out on each industry.

Initially, the sample consisted of 400 companies selected among the companies listed on the Main Market of Bursa during the period 2006 to 2010. After vetting through the sample selection criteria and adjusting for outliers, a sample consisting of 384 companies was formed and 16 companies were eliminated. These sampled companies are classified into 7 sectors covering all the major sectors of the Main Market of Bursa namely Industrial Products (IP), Consumer Products, Trading and Services (CTS), Finance (Fe), Technology (Ty), Construction (Cn), Properties (Ps) and Plantation (Pn). The infrastructure project, mining, real estate investment trust (REIT) companies, closed-end fund and hotels are excluded in this study because there is only a very minimal number of firms in these sectors listed on the Main Market of Bursa.

Table 1 shows the population mean of the Main Market listed companies as at 23rd September 2011 and the distribution of the sample used in this study in accordance with the industry in which they are listed in the Main Market. As shown in Table 1, the sample size represents 45 percent of the total listed companies in the Main Market of Bursa as at 23rd September 2011. In specific, this comprises 46 percent, 41 percent, 62 percent, 45 percent, 50 percent, 58 percent and 55 percent of the total number of listed companies in industrial products, consumer, trading and services, finance, technology, construction, properties and plantation sectors of the Main Market of Bursa respectively.

Table 1: Industry classification of the Main Market listed companies and sample distribution

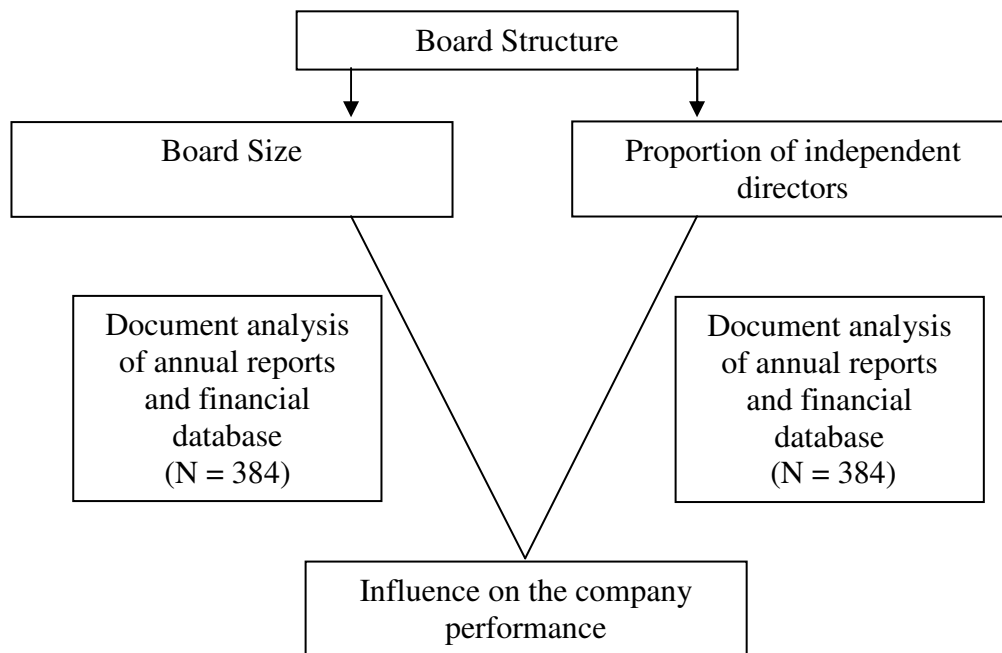
Sector	Acronym	Population Mean of Companies	No. of Sampled Companies	Percentage
Industrial Products	IP	261	119	46%
Consumer Products, Trading & Services	CTS	319	131	41%
Finance	Fe	39	24	62%
Technology	Ty	29	13	45%
Construction	Cn	44	22	50%
Properties	Ps	90	52	58%
Plantation	Pn	42	23	55%
Hotels	-	4	-	-
Infrastructure Project	-	7	-	-
Mining	-	1	-	-
REITS	-	14	-	-
Closed-end Fund	-	1	-	-
Total		851	384	45%

The published annual reports for the past five years namely 2006, 2007, 2008, 2009 and 2010 are collected from the Bursa's website and/or the official websites of the selected companies. The structure of the board in the form of the board size and the number of independent directors in the board are extracted directly from these annual reports. Using these data, the proportion of independent directors on the board is calculated which is represented as the percentage of directorship held by independent directors over the board size.

The financial data needed from the sampled companies are obtained from the financial statistics published in the website of www.bursastation.com. The collected financial data are cross-checked with the sampled companies' annual reports to ensure that the statistics collected from the website are not bias and as reported in the published annual reports. Furthermore, since this study covers a period of five years, the availability of the annual reports and financial data, which

are the source of information, is a deciding factor as to whether a particular company can be included. In other words, companies with insufficient data to access the variables are also eliminated from this study.

Figure 1: Research design: Influence of the board structure on the company performance



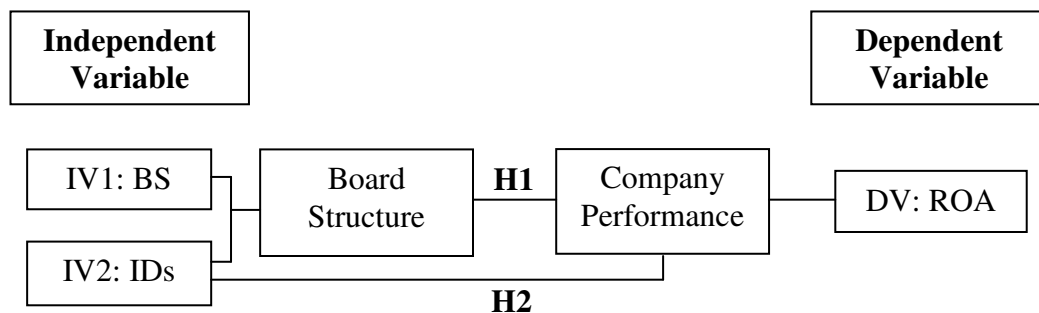
3.2 Variables

This study examined the Malaysian companies' board structures and their effect on the companies' performance. To avoid the effects of multicollinearity between board size and the number of independent directors, this study selected the proportion of independent directors on the board for analysis following the explanation provided by Ma and Tian (2009). The independent variables of the board structure were thus decided in the form of board size and the proportion of independent directors on the board. The board size is defined as the total number of directors on the board while the proportion of independent directors on the board is measured in terms of the percentage of the membership held by the independent directors on the board which has been widely used by past researchers (Mashayekhi & Bazaz, 2008; Ponnu, 2008; Sakawa et al. 2009; Rashid et al, 2010; Paul et al., 2011). For the purpose of this study, BS and IDs are

used to represent the board size and the proportion of independent directors on the board respectively.

The dependent variable, on the other hand, is the performance of the companies listed on the Main Market of Bursa. One of the issues in analysing company performance is the selection of the performance measure. There are various methods which have been used by past researchers in measuring the company performance such as stock price, Tobin's Q, return on asset, return on equity, return on capital employed, earning per share and dividend per share (Mashayekhi & Bazaz, 2008; Ponnu, 2008; Rashid et al., 2010; Paul et al., 2011; Mohd Saat et al., 2011). To avoid conflicting results from using more than one performance measure, this study uses only a single performance variable namely return on asset (ROA) measure for further analysis. ROA is an accounting ratio that shows the percentage of profit that a company generates in relation to its own resources, and is calculated by dividing net income (profit after tax) by the total assets (Answers.com, n.d.).

Figure 2: Research conceptual framework: Independent, dependent variables and hypotheses



3.3 Hypotheses

Based on the literature review conducted, the hypotheses developed in this study are as follow:-

H1: There is a significant linear relationship between the board structure and company performance.

H2: The proportion of independent directors on the board has a significant positive impact on the company performance.

3.4 Data Analysis Method

For the purpose of this study, descriptive statistics (in the forms of median, mode, mean, minimum, maximum and standard deviation) are obtained to gain an understanding of the characteristics of the company performance and board structure in terms of board size and proportion of independent directors on the board of the sampled companies during the five periods observed across different sectors. A simple correlation analysis is carried out to measure how significant each variable, namely the board size, the proportion of independent directors on the board and the company performance in ROA measure are related with each other across different sectors.

To evaluate the relationship between board structure and company performance, all the data obtained for the five periods observed are pooled together for each sector and are examined using regression model. All the hypotheses are empirically tested using the pooled ordinary least square model as follows:-

$$ROA_t = \beta_0 + \beta_1 IDS_t + \beta_2 BS_t + \varepsilon_t$$

where;

- ROA_t is return of assets for the period of time, t which is the dependent variable in this study;
- IDS is the proportion of independent directors on the board for the period of time t;
- BS is the board size for the period of time t;
- β_1 and β_2 are the regression coefficient estimates which are the amount by which the ROA changes when the particular independent variable either the IDs and BS, increases by one unit, with the values of all the other independent variables held constant; and
- ε_t is the error terms or residuals for the period of time t.

The model estimations in this study are organised in the following order:-

First, the significance of the regression model are assessed for each sector by checking on its coefficient of determination (R^2), standard error of estimates of the regression model and also the autocorrelation test of the residuals of the independent variables. Both the R^2 and the standard error of estimate are used to diagnose how precise the prediction of the company performance measured in ROA by the regression model. A higher value of R^2 and a lower value of the standard error of estimate indicate more variation in the company performance (ROA) is explained by the combination of variations of the board size and the proportion of independent directors on the board. In other words, there is no significant difference which exists between the ROA predicted by the regression model and the actual observed ROA. In contrast, the higher the values of the standard error of estimate, the observed ROA values practically differ significantly from the predicted ROA values on the regression line.

Autocorrelation occurred when successive residuals are correlated. According to Lind, Marchal and Wathen (2008), successive residuals are often correlated in time series data because an event in one period often influences the event in the subsequent period. The Durbin-Watson statistic, denoted by the letter d , is thus used in this study to test the independence of successive residuals which is one of the assumptions that underpins regression use. The null and alternate hypotheses to be tested are as follow:

$$H_0 = \text{No residual correlation}$$

$$H_1 = \text{Residual correlation}$$

The critical values of lower d (d_l) and upper d (d_u) at five percent significance level for each of the regression model are first obtained. The d statistics are then computed for each model which will range in value from 0 to 4. The decision rule is to reject the null hypothesis if the computed value for d is less than d_l and not to reject the null hypothesis if the computed value for d is more than d_u . No conclusion is reached if the computed value for d is between d_l and d_u .

Subsequently, two empirical tests namely global F-test and t-test are carried out in the regression analysis. The purpose of global F-test is to determine the statistical significance of the regression models and the existence of linear

relationships between variables. Null and alternate hypotheses were formulated as follows:-

$$H_0 : \beta_1 = \beta_2 = 0 \text{ (No linear relationship between ROA, IDs and BS)}$$

$$H_1 : \beta_1 \neq \beta_2 \neq 0 \text{ (Linear relationship exists between ROA, IDs and BS)}$$

A five percent level of significance is chosen for the test. If the computed probability value (p-value) for F-statistic is smaller than critical p-value of 0.05, the null hypothesis is thus rejected. In this case, there is a significant linear relationship between the board composition and company performance. On the contrary, if the computed p-value for F-statistic exceeds the critical p-value of 0.05, there is no linear relationship between the board composition and company performance.

T-test is carried out to determine the significance of regression coefficients of each independent variable in influencing the dependent variable, ROA. Null and alternate hypotheses are formulated as follow:-

$$H_0 : \beta_1 = 0; \quad H_0 : \beta_2 = 0 \quad \text{(Is not a significant determinant of ROA)}$$

$$H_1 : \beta_1 \neq 0; \quad H_1 : \beta_2 \neq 0 \quad \text{(Is a significant determinant of ROA)}$$

In this instance, at five percent level of significance, if the computed p-value for t-statistic falls below the critical p-value of 0.05, the null hypothesis is therefore rejected. Thus, it can be concluded that the independent variable either the proportion of independent directors on the board or the board size is a significant determinant of company performance. Likewise, if the computed p-value for t-statistic exceeds the critical p-value of 0.05, independent variable either the proportion of independent directors on the board or the board size is not a significant determinant of company performance.

Finally, diagnostic checking on the effects of multicollinearity is carried out to determine how reliable the results are. Multicollinearity refers to high correlations among the independent variables. Highly correlated independent variables may lead to erroneous results. To test the effect of multicollinearity among the independent variables namely the board size and the proportion of independent directors on the board, the collinearity statistics in the form of variance inflation factor (VIF) and tolerance are obtained for study. If the

collinearity statistics reveal that the VIF of the independent variables are not greater than 10 with the tolerance more than 0.10, this would indicate that the independent variables are not strongly correlated to each other.

All the empirical results are presented in the next chapter.

CHAPTER 4

RESEARCH RESULTS

The empirical results of this study are presented in three sections. Firstly, the descriptive statistics about the variables used namely board size, proportion of independent directors on the board and company performance are explained. Secondly, the correlations between these variable are explored. Lastly, the impact of the board size and the proportion of the board's independent directors on the company performance are revealed.

4.1 Descriptive Statistics of the Sample

To gain an understanding of the background of all the variables used in this study, the descriptive statistics of all these variables are thus explored.

4.1.1 Board Size

Table 2 provides the descriptive statistics in the forms of median, mode, minimum and maximum of the board size in the sample. The overall median of the board size in the sample is 7 for all the period observed from 2006/2007 to 2010/2011 ranging from minimum of three directors to the maximum of fifteen directors as shown in Table 2.

The highest median of the board size for the periods observed is recorded at 8.5 by the finance (Fe) and construction (Cn) sectors for the period of 2010/2011 and 2009/2010 respectively. In addition, both sectors also posted the highest median of the board size among the sectors observed for the period of 2006/2007 and 2007/2008 as well as for the period of 2008/2009 together with technology (Ty) sector at 8. With the exception of the technology, construction and plantation (Pn) sectors for the period of 2010/2011, finance and technology

sectors for the period of 2009/2010 and all the foregoing results, the rest of the sectors observed posted a median of the board size at 7.

Table 2: Descriptive statistics (n=384) of cross section data for board size

Year		Board size in accordance to sector							
		IP	CTS	Fe	Ty	Cn	Ps	Pn	Overall
2006/ 2007	Median	7	7	8	7	8	7	7	7
	Mode	7	8	6 ^a	8	8	6 ^a	6 ^a	8
	Minimum	3	3	4	4	6	5	4	3
	Maximum	15	12	13	11	14	12	12	15
2007/ 2008	Median	7	7	8	7	8	7	7	7
	Mode	7	8	8	7	8	6	8	7
	Minimum	3	4	4	4	6	5	4	3
	Maximum	15	12	13	11	14	13	12	15
2008/ 2009	Median	7	7	8	8	8	7	7	7
	Mode	6	7	9	7	7	6	6 ^a	7
	Minimum	4	4	5	6	6	5	5	4
	Maximum	15	12	13	11	14	13	12	15
2009/ 2010	Median	7	7	8	8	8.5	7	7	7
	Mode	6	7	10	6 ^a	10	6	8	6
	Minimum	4	3	4	5	4	5	5	3
	Maximum	15	13	13	11	14	13	12	15
2010/ 2011	Median	7	7	8.5	8	8	7	8	7
	Mode	6	7	7 ^a	8	7 ^a	7	8	7
	Minimum	4	3	3	4	4	4	5	3
	Maximum	15	12	14	11	13	13	12	15

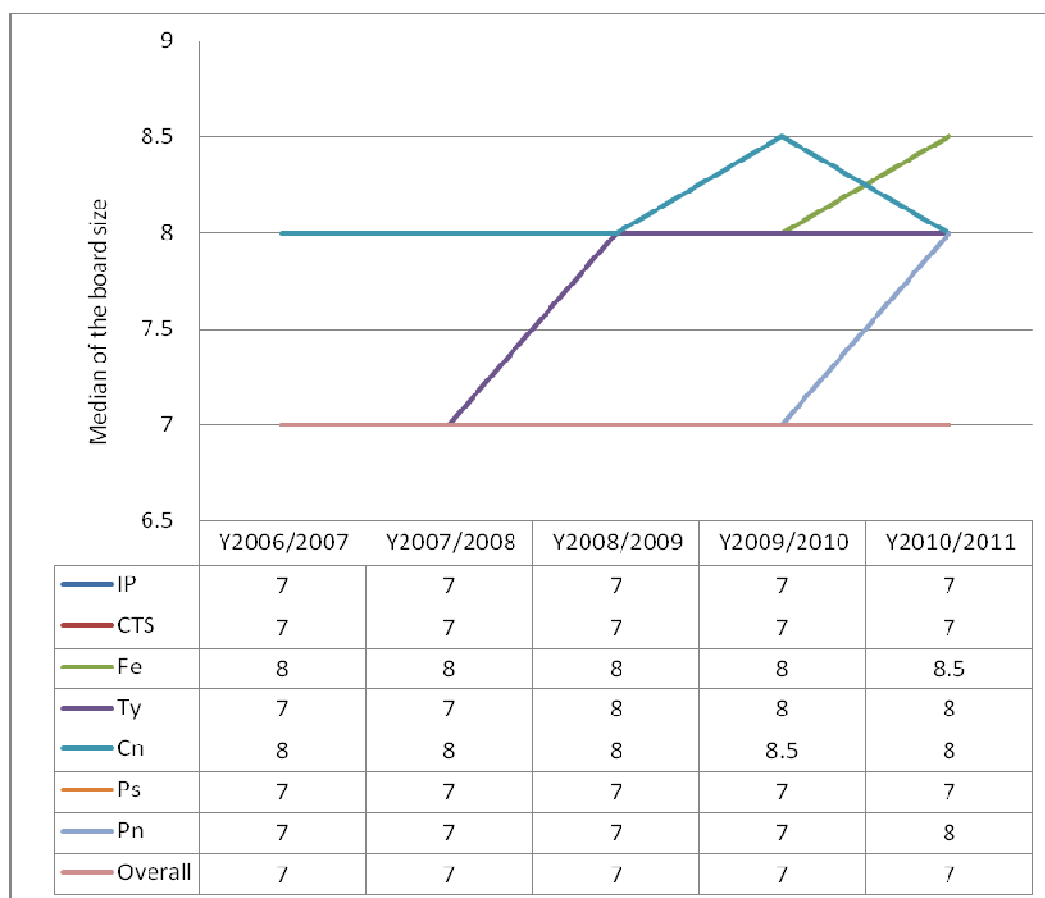
^a Multiple modes exist. The smallest value is shown.

In term of the measurement of the board size in mode value, the highest mode is recorded by the finance and construction sectors for the period of 2009/2010 at 10 followed by the finance sector for the period of 2008/2009 at 9. Overall, most of the sectors observed posted mode of the board size of 7 for the periods of 2007/2008, 2008/2009 and 2010/2011, mode of 6 for the period of 2009/2010 and mode of 8 for the period of 2006/2007.

The trend of the sample median of board size in this study during the periods observed from 2006/2007 to 2010/2011 is presented in Figure 3. Among

the sectors observed, only the construction (Cn) sector shows that the median of their board sizes fluctuated during the periods observed where the median increased from 8 to 8.5 during the period of 2009/2010 but subsequently dropped to 8 during the period of 2010/2011. By comparison, companies from the technology (Ty) and plantation (Pn) sectors show that the median of their board sizes increased the most from 7 to 8 during the period of 2008/2009 and 2010/2011 respectively. Similarly, the finance (Fe) companies also show a slight increase of the median of their board size from 8 to 8.5 during the period of 2010/2011. The remaining sectors observed namely industrial (IP), consumer products, trading and services (CTS) and properties (Ps) on the other hand demonstrate constant median of their board size throughout the periods observed at 7.

Figure 3: The trend of the sample median of board size from 2006/2007 to 2010/2011



Nevertheless, the overall median of the board size during the periods observed from 2006/2007 to 2010/2011 remain constant at 7 although the trends of the median of the board size differ across the sectors observed.

4.1.2 Proportion of independent directors on the board

Table 3 presents the descriptive statistics on the proportion of independent directors on the board across different sectors.

Table 3: Descriptive statistics (n=384) of cross section data for proportion of independent directors on the board

Year		Percentage of independent directors in accordance to sector							
		IP	CTS	Fe	Ty	Cn	Ps	Pn	Overall
2006/ 2007	Mean	40.3	41.26	44.88	39.46	39.23	43.63	45.78	41.6
	Minimum	22	18	25	25	29	29	29	18
	Maximum	67	75	75	67	63	71	71	75
	Sd	9.6	10.509	12.55	11.252	9.081	11.52	11.65	10.612
2007/ 2008	Mean	41.96	41.87	45.62	44.38	38.68	43.79	44.17	42.43
	Minimum	20	22	29	33	25	20	25	20
	Maximum	80	75	67	60	57	70	71	80
	Sd	10.958	10.55	10.265	8.968	8.638	11.534	12.067	10.769
2008/ 2009	Mean	44.17	44.36	48.04	43.85	37.41	46.08	45.57	44.42
	Minimum	22	25	30	33	29	22	29	22
	Maximum	83	80	67	57	57	83	71	83
	Sd	11.887	11.394	10.984	8.174	8.754	12.482	12.699	11.631
2009/ 2010	Mean	43.8	44.78	48.08	42.92	39.68	44.62	47.26	44.45
	Minimum	22	25	22	33	29	17	29	17
	Maximum	83	75	75	60	75	71	86	86
	Sd	12.526	11.233	13.574	9.26	12.407	11.625	15.351	12.155
2010/ 2011	Mean	43.72	45.08	49.42	45.85	41.64	45.15	46.87	43.72
	Minimum	22	29	29	33	27	22	29	22
	Maximum	83	78	75	75	75	75	80	83
	Sd	12.691	11.021	12.566	12.233	13.236	12.325	14.861	12.253

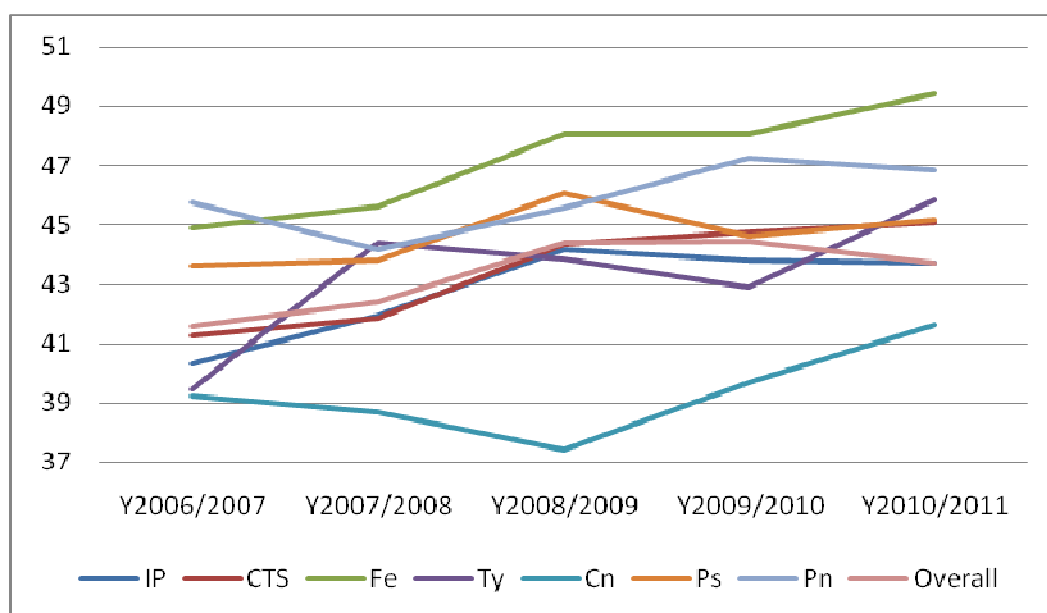
Notes: Sd represents standard deviation.

In relation to the proportion of independent directors on the board, the overall average percentage of independent directors over the board size across different period is 41.6 percent, 42.43 percent, 44.42 percent, 44.45 percent and

43.72 percent for the period of 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively ranging from a minimum proportion of 17 percent to a maximum of 86 percent of the board size with an average standard deviation ranging from 10.612 to 12.253 as per Table 3. Among the sectors observed, the plantation sector posted the highest mean proportion of independent directors on the board for the period of 2006/2007 at 45.78 percent whereas the finance sector shows the highest mean proportion of independent directors on the board for the rest of the periods observed namely 2007/2008 (45.62 percent), 2008/2009 (48.04 percent), 2009/2010 (48.08 percent) and 2010/2011 (49.42 percent). Conversely, the lowest mean proportion of independent directors on the board is recorded by the construction sector for all the periods observed at 39.23 percent, 38.68 percent, 37.42 percent, 39.68 percent and 41.64 percent for the period of 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Figure 4 shows the trend of the sample mean of the proportion of independent directors on the board used in this study during the periods observed from 2006/2007 to 2010/2011.

Figure 4: The trend of the sample mean of the proportion of independent directors on the board from 2006/2007 to 2010/2011



As illustrated in Figure 4, the overall mean proportion of independent directors on the board demonstrates an increasing trend from the period of

2006/2007 to 2009/2010 registering from 41.6 percent to 44.45 percent and dropped slightly which only accounted less than 1 percent during the period of 2009/2010 to 2010/2011 to 43.72 percent. Nevertheless, the slight drop of the mean proportion of independent directors on the board is generally attributed to the industrial products (IP) and plantation (Pn) sectors as only these two sectors show decrease of the mean proportion of independent directors on the board during the period of 2009/2010 to 2010/2011. Among all the sectors observed, only the finance (Fe) sector show that their proportion of independent directors on the board increases throughout all the periods observed beginning with 44.88 percent in 2006/2007 to 45.62 percent, 48.04 percent, 48.08 percent and 49.42 percent in 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively while the rest of the sectors observed recorded a slight drop of the proportion during the interval of the period from 2006/2007 to 2010/2011. Despite the slight drop registered for most of the sectors observed except the finance sector during the period interval, the mean of the proportion of independent directors on the board for all sectors has however increased for the period 2010/2011 as compared to the period of 2006/2007.

4.1.3 Company Performance

The descriptive statistics of the company performance measured by the return on assets (ROA) in the sample are shown in Table 4. From Table 4, the average company performance is 3.253 percent, 4.216 percent, 3.128 percent, 3.653 percent and 3.549 percent under the ROA performance measure for the period of 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively ranging from -53.751 percent to 54.574 percent with a standard deviation ranging from 7.304 to 8.628.

In specific, the highest average ROA for the period 2006/2007 is recorded by the consumer products, trading and services sector at 4.898 percent while the highest average ROA for the rest of the periods observed namely 2007/2008 (8.61 percent), 2008/2009 (8.223 percent), 2009/2010 (5.510 percent) and 2010/2011 (6.391 percent) are achieved by the plantation sector. It is also to be noted that the maximum ROA for all the periods observed among the different sectors is achieved by the consumer products, trading and services sector.

In general, the standard deviations of the ROA for the entire sectors are high. With the exception for the period of 2006/2007, the lowest standard deviation of the ROA for most of the periods observed is recorded by the finance sector at 2.804, 3.347, 2.835 and 2.502 for the period of 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively. For the period of 2006/2007, the lowest standard deviation of the ROA is recorded by the plantation sector at 3.080.

Table 4: Descriptive statistics (n=384) of cross section data for company performance measured by ROA

Year		Return on assets in accordance to sector							
		IP	CTS	Fe	Ty	Cn	Ps	Pn	Overall
2006/ 2007	Mean	2.418	4.898	1.975	2.995	1.164	1.965	4.589	3.253
	Minimum	-53.751	-41.773	-6.932	-26.947	-22.301	-19.137	-2.922	-53.751
	Maximum	23.599	44.419	10.352	18.919	11.347	12.558	10.928	44.419
	Sd	9.927	9.495	3.510	11.158	6.902	5.379	3.080	8.628
2007/ 2008	Mean	3.504	5.291	2.841	3.941	3.001	2.412	8.610	4.216
	Minimum	-14.050	-44.271	-0.720	-4.402	-5.520	-16.252	0.129	-44.271
	Maximum	15.612	50.582	11.077	17.581	14.533	17.270	14.812	50.582
	Sd	6.154	9.771	2.804	6.594	5.482	5.561	3.725	7.405
2008/ 2009	Mean	1.580	4.640	0.903	1.767	3.393	1.861	8.223	3.128
	Minimum	-22.228	-20.813	-6.528	-8.779	-8.416	-14.475	-3.843	-22.228
	Maximum	16.576	54.574	12.176	13.860	30.664	12.248	18.631	54.574
	Sd	7.012	8.542	3.347	8.046	7.664	4.721	5.729	7.374
2009/ 2010	Mean	3.067	4.920	2.159	2.493	2.605	2.400	5.510	3.653
	Minimum	-34.269	-22.740	-1.570	-9.174	-6.996	-7.419	-2.501	-34.269
	Maximum	32.046	51.783	11.713	14.078	16.478	9.078	13.197	51.783
	Sd	7.874	8.865	2.835	5.902	5.694	3.861	3.975	7.304
2010/ 2011	Mean	2.785	4.489	2.102	2.229	3.277	2.782	6.391	3.549
	Minimum	-45.645	-32.423	-1.264	-16.765	-10.045	-13.141	-6.530	-45.645
	Maximum	27.151	46.593	9.023	11.632	17.367	15.378	17.400	46.593
	Sd	8.232	10.262	2.502	7.983	6.258	4.849	4.656	8.171

Note: Sd represents standard deviation.

4.2 Correlations between Board Structure and Company Performance

Table 5 presents the results of the correlation analysis carried out to assess the association between the board composition and company performance. Overall, board size (BS) is negatively and significantly correlated (p -value < 0.05) with the proportion of independent directors on the board (IDs) during the period from 2006/2007 to 2010/2011 but it has positive and significant correlations with company performance measured by return of assets (ROA) for the period of 2008/2009, 2009/2010 and 2010/2011.

Table 5: Correlations between variables in the model

Year		Coefficient of correlation in accordance to sector															
		IP		CTS		Fe		Ty		Cn		Ps		Pn		Overall	
		<i>p</i>	S	<i>p</i>	S	<i>P</i>	S	<i>p</i>	S	<i>p</i>	S	<i>p</i>	S	<i>p</i>	S	<i>p</i>	S
2006/ 2007	ROA & IDs	0.009	-	0.389	-	0.888	+	0.374	-	0.800	-	0.037	+	0.378	-	0.065	-
	ROA & BS	0.332	+	0.563	+	0.162	-	0.039	+	0.781	+	0.242	+	0.543	+	0.119	+
	BS & IDs	0.035	-	0.035	-	0.160	-	0.913	-	0.198	-	0.626	-	0.037	-	0.000	-
2007/ 2008	ROA & IDs	0.866	-	0.680	-	0.014	-	0.706	-	0.744	-	0.765	+	0.398	-	0.582	-
	ROA & BS	0.035	+	0.308	+	0.734	-	0.214	+	0.276	-	0.093	+	0.883	+	0.054	+
	BS & IDs	0.004	-	0.072	-	0.382	-	0.360	-	0.047	-	0.932	+	0.060	-	0.000	-
2008/ 2009	ROA & IDs	0.033	-	0.288	-	0.386	-	0.849	+	0.270	-	0.446	-	0.828	-	0.014	-
	ROA & BS	0.282	+	0.175	+	0.634	+	0.143	+	0.639	+	0.028	+	0.332	+	0.007	+
	BS & IDs	0.001	-	0.000	-	0.104	-	0.805	-	0.359	-	0.505	-	0.017	-	0.000	-
2009/ 2010	ROA & IDs	0.149	+	0.116	-	0.618	-	0.180	-	0.420	-	0.770	+	0.668	-	0.696	-
	ROA & BS	0.584	+	0.015	+	0.377	-	0.058	+	0.704	-	0.253	+	0.405	+	0.024	+
	BS & IDs	0.000	-	0.001	-	0.035	-	0.301	-	0.042	-	0.863	+	0.031	-	0.000	-
2010/ 2011	ROA & IDs	0.353	+	0.426	+	0.531	-	0.330	-	0.427	-	0.872	-	0.944	+	0.480	+
	ROA & BS	0.075	+	0.151	+	0.121	-	0.305	+	0.609	+	0.751	+	0.371	+	0.031	+
	BS & IDs	0.001	-	0.007	-	0.012	-	0.091	-	0.002	-	0.718	-	0.017	-	0.000	-

Notes:

p represents probability value of the coefficient of correlation;

S indicates the direction of the correlation whether the relationship is positive or negative; if p -value < 0.05 , correlation is significant at the 5 percent level of significance.

As for the correlation between proportion of independent directors on the board and company performance, most of the results show that proportion of independent directors on the board is generally not associated with company performance as indicated by its statistically insignificant correlation coefficients with ROA during the period of 2006/2007, 2007/2008, 2009/2010 and 2010/2011. It is however negative and significantly correlated with company performance for the period of 2008/2009.

Among the sectors observed, board size of the industrial products (IP), consumer products, trading and services (CTS), construction (Cn) and plantation (Pn) companies are negatively and significantly correlated with proportion of independent directors on the board for most, if not all, of the periods observed. In addition, it is also important to note that almost all the results from the different sectors show positive correlations between board size and company performance for all the periods observed with significant associations ($p\text{-value} < 0.05$) recorded for the companies on industrial products (IP), consumer products, trading and services (CTS), technology (Ty) and properties (Ps) for the period of 2007/2008, 2009/2010, 2006/2007 and 2008/2009 respectively. However, the proportion of independent directors on the board is somehow negatively correlated with the company performance for most of the sectors and periods observed with significant associations ($p\text{-value} < 0.05$) reported for industrial product sector for the period of 2006/2007 and 2008/2009 and finance sector for the period of 2007/2008.

4.3 Regression Model of Board Structure and Company Performance

Table 6 shows the summary of the assessment of the regression model of company performance measured in ROA on the board structure. The calculated coefficient of determination (R^2) reveals that the independent variables in the combination of board size (BS) and proportion of independent directors on the board (IDs) explain only about 1.3 percent of the variation in return of assets (ROA) for industrial products (IP) sector, 1.4 percent for consumer products,

trading and services (CTS) sector, 8.9 percent for finance (Fe) sector, 20.2 percent for technology (Ty) sector, 2.6 percent for construction (Cn) sector, 3.5 percent for properties (Ps) sector and 2.5 percent for plantation (Pn) sector. These results indicate that the regression model used has low predictive power in company performance in ROA measure since the R^2 for all the sectors are at a very weak level with the highest being only 20.2 percent while the others generate readings below 10 percent.

Moreover as shown in Table 6, the calculated standard error of estimate (s_e) of the regression model are considerably high with the lowest value being recorded in finance sector ($s_e = 2.924$) followed by plantation ($s_e = 4.509$), properties ($s_e = 4.815$), construction ($s_e = 6.358$), technology ($s_e = 7.187$), industrial products ($s_e = 4.509$), and last by consumer, trading and services ($s_e = 9.329$) sectors. The best fit regression model between the board structure and company performance among all the sectors observed is thus the regression model for finance sector since this sector had recorded the smallest error among all the sectors observed. Given that all the calculated s_e for all the sectors observed are considerably high, this deduces that the predicted ROA data are relatively not close to the regression line for all the sectors observed.

Table 6: Regression model of company performance^b

Model	Coefficient of determination (R^2)	Adjusted R^2	Standard Error of the Estimate	Durbin-Watson Statistic	F-statistic (F)
IP	.013	.009	7.903925	2.004	3.843
CTS	.014	.011	9.329237	2.052	4.735
Fe	.089	.073	2.923781	1.920	5.685
Ty	.202	.176	7.187305	1.705	7.828
Cn	.026	.008	6.358466	1.895	1.414
Ps	.035	.028	4.815381	2.034	4.725
Pn	.025	.007	4.509191	1.438	1.421

a. Predictors: (Constant), IDs, Board Size

b. Dependent Variable: ROA

Although the results from the calculated R^2 and s_e both revealed that the regression model has low predictive power in the company performance in ROA

measure, the regression model could still be used to determine whether the board structure in the form of board size and proportion of independent directors on the board have some relationship with the company performance as the dependent variable in all the different sectors using empirical tests namely global F-test and t-test.

As for the test of autocorrelation, the critical values of lower d (d_l) and upper d (d_u) at five percent level of significance with 2 numbers of independent variables ($k=2$) for each of the regression model are as follow:-

Model IP (where $n=595$): $d_l = 1.862$; $d_u = 1.869$;

Model CTS (where $k=655$): $d_l = 1.869$; $d_u = 1.875$;

Model Fe (where $k=120$): $d_l = 1.685$; $d_u = 1.719$;

Model Ty (where $k=65$): $d_l = 1.567$; $d_u = 1.629$;

Model Cn (where $k=110$): $d_l = 1.671$; $d_u = 1.707$;

Model Ps (where $k=260$): $d_l = 1.789$; $d_u = 1.804$;

Model Pn (where $k=115$): $d_l = 1.678$; $d_u = 1.713$;

Among all the sectors observed, there appears to be autocorrelation in the regression model of the plantation (Pn) sector only since the computed value for Durbin-Watson statistics (d) of 1.438 is less than d_l of 1.678. Hence, the assumption of independence of residuals has been violated in the regression model of the plantation sector. Such presence of autocorrelation means that the regression model of the plantation (Pn) sector may not yield the correct estimate. Given that most of the computed value for Durbin-Watson statistics (d) for the sectors observed are more than d_u , the null hypothesis that there is no residual correlation exists in between the independent variables namely the board size and the proportion of independent directors on the board is thus accepted for most of the sectors observed.

Table 7 provides the analysis of the variance on the impact of board structure and company performance measured by ROA. Hypothesis H1 predicted there is a significant linear relationship between the board structure and the company performance. As shown in Table 7, the results of F-statistic indicate that

the hypothesis H1 is statistically not rejected (p-value < 0.05). This deduces that the relationship between board structure and the company performance measured by ROA is linear and statistically significant for most of the sectors observed namely industrial products (p-value = 0.022), consumer products, trading and services (p-value = 0.009), finance (p-value = 0.004), technology (p-value = 0.001) and properties (p-value = 0.010). The relationship between board structure and company performance is however non-linear in the construction (p-value = 0.248) and plantation (p-value = 0.246) sectors.

Table 7: Analysis of variance (ANOVA) on the impact of board structure on company performance

Model		Sum of Squares	Degree of freedom (df)	Mean Square	F-statistic (F)	Probability value of F
IP	Regression	480.153	2	240.077	3.843	.022 ^a
	Residual	36983.443	592	62.472		
	Total	37463.597	594			
CTS	Regression	824.233	2	412.116	4.735	.009 ^a
	Residual	56746.595	652	87.035		
	Total	57570.828	654			
Fe	Regression	97.196	2	48.598	5.685	.004 ^a
	Residual	1000.174	117	8.548		
	Total	1097.371	119			
Ty	Regression	808.751	2	404.375	7.828	.001 ^a
	Residual	3202.756	62	51.657		
	Total	4011.507	64			
Cn	Regression	114.336	2	57.168	1.414	.248 ^a
	Residual	4326.019	107	40.430		
	Total	4440.356	109			
Ps	Regression	219.130	2	109.565	4.725	.010 ^a
	Residual	5959.289	257	23.188		
	Total	6178.419	259			
Pn	Regression	57.785	2	28.893	1.421	.246 ^a
	Residual	2277.274	112	20.333		
	Total	2335.059	114			

a. Predictors: (Constant), IDs, Board Size

b. Dependent Variable: ROA

Table 8 shows the ordinary least square regression results of the company performance in ROA measure on the independent variables of board size and proportion of independent directors on the board. With regards to Hypothesis H2 testing, the results of the t-test on regression coefficients (β) reveal that significant negative relationship exists only in finance sector ($\beta = -0.051$, p-value = 0.036) between the proportion of independent directors on the board (IDs) and the company performance. In addition, the results of the t-test also show that a non-significant negative relationship exists between the proportion of independent directors on the board and company performance in almost all the other sectors namely industrial products ($\beta = -0.007$), consumer products, trading and services ($\beta = -0.023$), technology ($\beta = -0.094$), construction ($\beta = -0.107$) and plantation ($\beta = -0.010$) sectors save and except the properties ($\beta = 0.023$) sector. In view of the foregoing results, Hypothesis H2 predicted that the proportion of independent directors on the board has a significant positive relationship to company performance is thus rejected in all models.

Table 8: Regression coefficients of company performance (in ROA measure)

		ROA as dependent variable						
		IP	CTS	Fe	Ty	Cn	Ps	Pn
No. of observation		595	655	120	65	110	260	115
Intercept	β	-0.254	1.457	7.580	-6.021	8.762	-2.410	4.709
	(p)	(0.900)	(0.552)	(0.000)	(0.323)	(0.054)	(0.164)	(0.115)
BS	β	0.447	0.587	-0.388	1.707	-0.219	0.489	0.321
	(p)	(0.010)	(0.006)	(0.002)	(0.001)	(0.505)	(0.003)	(0.179)
IDs	<i>Tolerance</i>	0.921	0.945	0.878	0.950	0.830	0.999	0.796
	<i>VIF</i>	1.086	1.059	1.139	1.052	1.205	1.031	1.257
	<i>B</i>	-0.007	-0.023	-0.051	-0.094	-0.107	0.023	-0.010
	(p)	(0.813)	(0.493)	(0.036)	(0.310)	(0.096)	(0.358)	(0.775)
	<i>Tolerance</i>	0.921	0.945	0.878	0.950	0.830	0.999	0.796
	<i>VIF</i>	1.086	1.059	1.139	1.052	1.205	1.031	1.257

Notes: β represents regression coefficient; probability value (p) of t-test are presented in parentheses; if $p < 0.05$, relationship is significant at the 5 percent level of significance

Surprisingly, the results of the t-test on regression coefficients (β) in Table 8 further reveal that the relationship between board size and company performance is positive and statistically significant (p-value < 0.05) in most

sectors comprising industrial products ($\beta = 0.447$, p-value = 0.010), consumer products, trading and services ($\beta = 0.587$, p-value = 0.006), technology ($\beta = 1.707$, p-value = 0.001) and properties ($\beta = 0.489$, p-value = 0.003) sectors. The relationship is however negative and statistically significant in the finance ($\beta = -0.388$, p-value = 0.002) sector, negative and insignificant for the construction ($\beta = -0.219$, p-value = 0.505) sector and positive and insignificant for the plantation ($\beta = 0.321$, p-value = 0.179) sector.

Finally, on the assessment of the existence of the multicollinearity problem, Table 8 demonstrates that all the sectors observed recorded the variance inflation factor (VIF) value of less than 10 and tolerance value of more than 0.10 among the two independent variables namely board size and the proportion of independent directors on the board. Such finding shows that the problem of multicollinearity does not occurred and all data of the two independent variables are mutually exclusive.

The next chapter provides the discussion and conclusion of the detailed analysis of the empirical results.

CHAPTER 5

DISCUSSION AND CONCLUSION

Since the 1997/8 financial crisis that hit Malaysia, Malaysian listed companies are under increasing pressure from the regulators namely the Companies Commission of Malaysia, Securities Commission and Bursa Malaysia targeting in the reform of the structure of their board to ensure good corporate governance in their entities. Just recently, for instance, new rules have been implemented by the Securities Commission by prosecuting directors who have caused wrongful loss to the companies (Jayaseelan, Tee & Tan, 2010) as well as to direct companies to change their directors who do not have the requisite qualities to discharge their roles effectively by Bursa (Oh, 2010). To understand the contribution of independent directors, this study reviewed the roles, responsibilities, qualifications and qualities of independent directors and examined the impact of the board structure in terms of board size and proportion of independent directors on the company performance.

5.1 Summary

An independent director holds the same fiduciary duties similar to any other director which is to act for a proper purpose and in the best interest of the company. Being a qualified independent director, he or she must not have a personal relationship with the company and must not have been engaged in some business with the company within the last two years. Their roles and responsibilities are to independently evaluate and monitor the board and management performance, staffing key committees of the board, influencing the function of the board as a whole by providing advice and assistance in the areas on successive planning, change of corporate control and audit function, executive

remuneration, and most importantly, to provide sound independent judgments especially in the areas where conflict of interests occurred.

To effectively perform their roles and responsibilities, they must have the compulsory qualities namely the character, experience, integrity, competence and commitment as required by Bursa (as cited in Oh, 2011) in its Main Market Listing Requirements as amended and with effect from 3rd January 2012. As such, they must have independent characters to act honestly in giving opinion to the best interests of the companies, diligence to effectively devote the necessary time and effort to carry out the duties given to him and be competent with the necessary knowledge, skill and experience related to his responsibilities to provide added values to the companies.

Generally, the results of the descriptive analysis on cross section data in this study revealed that not all the Malaysian listed companies comply with the Main Market Listing Requirements imposed by Bursa (2009) on the maximum board size of 10 for listed companies and having one third of the board to be occupied by independent directors. Among the sectors observed, only the companies in the technology sector comply with the proportion of independent directors on the board imposed by Bursa (2009) from the period 2007/2008 onwards. Looking at the trend of the board size and the proportion of independent directors on the board from the period of 2006/2007 to 2010/2011, this study found that the overall median of the board size does not vary but there is a slight increase of the mean proportion of independent directors on the board during the period of 2006/2007 to 2010/2011. This implies that in the last five years, the boards of Malaysian listed companies have become more independent replacing their executive directors with independent directors, but the size of their boards remain unaltered.

In relation to the link between company performance and board size, this study as a whole finds the board size being negatively correlated with the proportion of independent directors on the board but has a positive correlation with company performance measured by return of assets and is significant after the period of 2008/2009. This indicates that the larger the board size, the lesser the presence of the independent directors and in general, companies with larger board

size reflect better financial performance. As for the link between proportion of independent directors on the board and company performance, this study finds a negative correlation between the proportion of independent directors on the board and company performance in ROA measure across most of the sectors observed. Overall, the proportion of independent directors on the board is significantly correlated with company performance for the period of 2008/2009. By having all these correlation results, these imply that the company performance may therefore be enhanced by increasing the board size but not by increasing the number of independent directors on the board.

Thereafter, this study further investigated whether or not the structure of the boards of the Malaysian listed companies in different sectors could influence their performance. Board size and proportion of independent directors on the board are used as the independent variable and ROA is used as a measure of company performance. By examining the F-statistics of the regression results, this study apparently suggests that there is a significant linear relationship between board structure and the performance of the companies observed measured in ROA except the construction and plantation sectors.

Furthermore, the t-statistics of the proportion of independent directors on the board as the independent variable further revealed that there is no significant relationship between the proportion of independent directors on the board and the company performance measured in ROA in most sectors observed, supporting the findings from Bhagat and Black (2000), Ponnu (2008), Paul et al. (2011), Sakawa et al. (2009), Baxt et al. (2002) and Dalton et al. (1998). At the first glance, this may imply that independent directors do not influence company performance. However, this study finds a negative and significant relationship between the proportion of independent directors on the board and company performance in the finance sector. Having scrutinised the descriptive statistics of the proportion of independent directors on the board in the finance sector, this study reveals an increasing trend of the mean of the proportion of independent directors on the board from the period of 2006/2007 to 2010/2011 in the finance sector with the highest percentage among all the sectors observed being recorded from the period of 2007/2008 to 2010/2011 up to 49.42 percent. By relating the trend of the mean proportion of independent directors on the board with the negative and significant

relationship with the performance of the financial companies, this study deduced that the independent directors in the finance sectors may not perform their roles and responsibilities effectively, creating a significant adverse effect on their company performance.

Although the independent directors' candidates should be nominated by the nominating committee as recommended by the MCCG (2007), most of the time, the independent directors are appointed however merely to fulfill the Bursa Malaysia Main Market Listing Requirements and are not truly independent and have some affiliation with the management or major shareholders as they may have been appointed for excessively long terms (Bhagat & Black, 2000; Siow, 2009; Bushon, 2009) or they may have been appointed by the major shareholders (Goo & Carver, 2003; Bushon, 2009). The latter may explain why the proportion of independent directors on the board does not have significant adverse effect on the company performance in non-financial sectors as their boards were not mostly occupied by the Chairman's appointed independent directors. To ensure that the independent directors are truly independent and not associated with the Chairman or management, Goo and Carver (2003) recommended that companies need to have a proper process for appointment and removal of independent directors such as having at least one third of the independent directors appointed by independent shareholders rather than having all being appointed by the management or the controlling shareholders at present.

On the other hand, the t-statistics of the board size as the independent variable in this study also revealed that it is the board size that has a positive and significant influence on company performance under the ROA measure in most sectors namely industrial products, consumer products, trading and services, technology and properties sectors. Contrary to most of literatures as reviewed earlier that board size is negatively related to the company performance (Bhagat & Black, 2000; Panasian et al., n.d.; Shakir, n.d.; Bohren & Odegaard, 2005; Mashayekhi & Bazaz, 2008 and Rashid et al., 2010), this study finds that larger boards are however more effective in enhancing company performance measured in ROA than smaller boards in most sectors. Such finding is consistent with the findings obtained from Chang and Leng (as cited in Mashayekhi and Bazaz,

2008), and Ma and Tian (2009), that board size has a positive impact on the performance of the companies.

On the other hand, contrary to the positive relationship between board size and performance in the US banking industry found by Adam and Mehran (as cited in Shakir, n.d.), this study however reveals that the board size has a negative and significant influence on the performance measured by ROA of the listed financial companies comprised of a higher proportion of independent directors on the board compared to those in the non-financial sectors. This again indicates that the Malaysian financial companies have too many independent directors on their boards who do not have the necessary qualities and in turn adversely affect their company performance. In specific, these independent directors may not possess the essential knowledge about the accounting or financial business as claimed by Tan Sri Ramon Navaratnam (as cited in The Edge Malaysia, 2009b) which is an important knowledge and skill for the finance sector. Effort must therefore be taken to determine the proper role and responsibilities of the independent directors and to ascertain what qualities possessed by independent directors might best suit the core business of the companies. There should be a system to search and appoint qualified independent directors and those who have the necessary qualities to sit on the board to contribute to the company performance while protecting the board's independence.

5.2 Limitations of the Study

In interpreting the results of this study, several limitations should be noted. First, this study used only two variables namely board size and board composition which could influence the company performance in which the explanatory power of the combination of these two variables may not be good enough to predict the company performance accurately. There are other explanatory variables which have been found to have significantly influenced company performance in the past studies such as board leadership structures. For instance, Mohd Saat et al. (2011) concluded that the board leadership with the presence of senior independent directors and appointment of an independent director as the chairman of the board would enhance company performance. Second, this study used only one

performance indicator namely ROA to measure company performance. A more robust measure of company performance should include more than one performance indicator. Many past studies included more than one performance indicator to measure company performance. Finally, although the results of the descriptive statistics and correlation analysis are for the period observed from 2006/2007 to 2010/2011, the regression results however did not consider the effects of time over different periods. A more in-depth assessment should be established to include the effects of different time periods.

5.3 Implications of the Study

Despite its limitations, the findings from this study do contribute towards the understanding of the implication of independent directors particularly with respect to their roles, responsibilities, qualifications, qualities and their impact on the company performance. Whilst the presence of the regulations stipulating the proportion of independent directors on the board may enhance overall corporate governance, these regulations however will not reap financial benefit to the Malaysian companies as these independent directors may not be truly independent. Rather, a larger board size will improve company performance financially in most sectors. Nevertheless, increase in board sizes with too many independent directors will also adversely affect the performance of the companies significantly as in the finance sector shown in the present study. From the public policy perspective, it is believed that the findings of this study is helpful in providing additional insights to the regulators in regulating corporate governance practices towards improving the performance of the Malaysian companies. For now and strategic future of the functions of the board, this study thus recommends companies to review their board structure by searching the right balance between executive directors and independent directors namely by harmonising the independent directors' lack of knowledge about the company's business with the combination of experience and knowledge from the executive directors. Further, in order to make sure the independent directors appointed to the boards of the Malaysian companies are truly independent, there should be a condition on the maximum period to sit on the board similar to the corporate governance codes

established in the United Kingdom or China. This study thus suggests restricting independent directors from being appointed for more than six years continuously on the board which is in line with the regulation implemented in China. This would allow the newly appointed independent directors to learn the operation of their new companies in the first three years before they could effectively perform their roles and responsibilities which would contribute to the company performance in the following three years.

5.4 Recommendations for Future Study

For the future direction of the present research, a more detailed analysis to examine the influence of the board structure on the company performance could be undertaken incorporating other explanatory variables that could affect the company performance such as company growth opportunities, size of organisations, board leadership structures and also whether the positions of chairman of the board and chief executive officer are combined or separated. Besides, further study is also suggested to be carried out by using other performance measures to represent the company performance. Among the performance measures that have been commonly used in the past studies are return on equity (Paul et al., 2011; Mohd Saat et al., 2011; Ponnu, 2008 and Mashayekhi & Bazaz, 2008; Khan & Awan, 2012), earning per share (Paul et al., 2011; Mashayekhi & Bazaz, 2008) and also the market based performance measure such as Tobin's Q (Shakir, n.d.; Panasian et al., n.d.; Mohd Saat et al., 2011; Rashid et al., 2010; Khan & Awan, 2012) or market to book ratio (Sakawa et al., 2009). Finally, further research is recommended to include a detailed assessment of the relationship between board structure and company performance taking into account the effect of the different period of time.

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