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Corporate Governance and Performance of Government-Linked Companies (GLCS): GLC Transformation Program Effects

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Abstract

The objective of this study is to examine the relationships of corporate governance mechanisms towards firm performance. The corporate mechanism under the study includes board characteristics (board size, board independent, multiple directorships and senior government officer) and board meeting frequency. Performance is measured using ROA, ROE, and EPS. This study uses data from the annual reports of 23 final samples of Government-Linked companies for the year 2004 to 2009. The regression results show that only board meeting frequency is significant and has negative relationship with performance.

***Keywords**: Corporate governance, Government-linked companies, National policy*

1. INTRODUCTION

GLCs are companies that have commercial objectives in which government has controlling stake over them. GLCs are vital in supporting the developing countries in terms of social and contribute significant portion in Malaysia's economic structure. (Putrajaya Committee for GLC High Performance, 2005). Initially in 1983, the Malaysian government officially announced the privatization program in order to reduce the burden of government in the public sector. The objective was to promote competition and also to enhance productivity to spur economic growth (Economic Planning Unit [EPU], 1991). These privatized firms are referred to as government-linked companies (GLCs). These GLCs and their controlling shareholders constitute significantly to the Malaysian economy (Mokhtar, 2005).

GLCs contributed approximately RM260 billion in market capitalization or approximately 36% and 56% respectively of the market capitalization of Bursa Malaysia and the benchmark Kuala Lumpur Composite Index (Mokhtar, 2005). Furthermore, GLCs provide an estimated of 5% of national workforce. Thus, their existence is crucial in maintaining and stabilizing the nation's economy as a whole. They mainly act as service providers to the country such as key strategic utilities and services such as electricity, telecommunications, postal services, airlines, transportation, banking and financial services (PCG,2005). Through the period of time, since the privatization, GLCs keep evolving significantly. Some GLCs evolved from government branches to incorporated entities, other companies became GLCs after Malaysian Government acquired them in due to the Asian financial crisis, and some other companies started their business as the government-owned entities (PCG, n.d). Thus, since the GLCs are of the interest of Malaysian government, they play a crucial and active part in executing government policies and initiatives as well as building capabilities and knowledge in various sectors.

The restructuring of GLCs provides further clear evidence since the Malaysia Prime Minister, Dato' Seri Abdullah Ahmad Badawi announced the GLC Transformation program (GLCT) in

May 2004. This program was introduced due to the fact that GLCs are experiencing inconsistent underperformance prior the year 2000. The aim of this program is to enhance the performance and also stimulate the economic growth in GLCs. It also focuses on the corporate governance practices in GLCs. Thus, question that arises is whether the GLC Transformation program has an impact to the corporate governance mechanisms, and the performance of the GLCs.There are three underlying principles in the GLC Transformation program, namely (i) National Development Foundation (ii) Performance Focus and (iii) Governance, Shareholder value and Stakeholder Management (PCG, 2005). However this study is aiming at the second and third underlying principles of the overall GLC Transformation program.

The main objective of this study is to examine the relationship between corporate governance mechanism (board size, percentage of independent directors, percentage of senior government officer, percentage of multiple directorship and board meeting frequency) towards firm performance. This study is foreseen to contribute to the government of Malaysia. It is important to see whether the program has the impact on growth and also performance of GLCs. The findings may also be useful to the Putrajaya GLC High Committee (PCG) as the one who is responsible in setting up the design and implement comprehensive national policies to transform GLCs into high performing entities.

2. LITERATURE REVIEW

Issues on corporate governance are widely being discussed over the past few decades. According to Dennis and McConnell (2005), corporate governance is a mechanism for both institutional and market based, that can influence the managers or controllers of the firm to maximize value to the owners of the firm. Various researches have been conducted to examine corporate governance mechanism towards company performance. Such mechanisms include ownership structure, board composition, board and Chief Executive Officer (CEO) ownership, CEO compensation and tenure and so forth.
Dalton, Daily, Ellstrand and Johnson (1998) conducted a study to examine the effect of leadership structure and firm performance. They found that there is no relationship between the two variables. However, a study by Rhoades, Rechner and Sundaramurthy (2001) found that firms with separated structure have higher accounting return as compared to company with CEO duality. They found weak but significant relationship between leadership structure and firm performance.

In Asian region, Chen, Cheung, Stouraitis and Wong (2005) examines whether corporate governance affect firm performance, value and dividend payout in family controlled firms. The independent variables involved in this mechanism include CEO duality, composition of BOD and audit committee. Firm performance was measured using ROA, ROE and market to book value. They found that there was a negative relationship between CEO duality and firm performance (market to book ratio). The relationship was significant even after the controlling for industry and firm fixed effects. They concluded that companies with combined structure (role duality) have a lower performance.

Another study by Abdullah (2004), examined the effect of board composition and CEO on company performance (ROA, ROE, EPS and profit margin). The samples consist of all companies listed Kuala Lumpur Stock Exchange (KLSE) between 1994 and 1996. In contrary with Rechner and Dalton (1991), he found that the governance mechanism under this study did not have any relation to firm performance. He also found that board independence was negatively associated with CEO duality. In other words, firms with CEO duality have lower percentage of outside director.

3. RESEARCH METHODOLOGY

As this study attempts to examine whether the GLC Transformation program has any effect towards the performance of the GLCs, the initial sample is based on the 33 GLCs that has been mentioned in Bernama (23rd Oct 2009). These 33 GLCs are public listed companies that are currently being listed in Bursa Malaysia. The data of this study were extracted directly from the annual reports gathered from the Bursa Malaysia and also the companies own websites. The data were extracted from the balance sheet, income statements, board of director's profile and corporate governance statement of each individual annual report of these companies from the stated period (2004 to 2009).

The final samples consist of 23 companies as the rest were excluded for two reasons. The first reason was the availability of data. There are three companies that do not have the data from the period under the study. The second reason was due to the fact that the companies are in the finance sector. There were seven companies which are in finance sector. These GLCs were excluded because of the differences in the components of their financial statements relative to the non-finance sectors. It is important to make this study more consistent with the inclusion of examining only non-finance sector companies.
Below are the five hypotheses for the objective of the study:-

Table 1: The objective of the study

Symbol	Hypotheses
H1a	There is a negative relationship between board size and firm performance
H1b	There is a positive relationship between the proportion of independent directors in the board and firm performance
H1c	There is a negative relationship between the proportion directors that have multiple directorships in the board and the firm performance
H1d	There is a negative relationship between the proportion of senior government officer in the board and firm performance
H1e	There is a negative relationship between board meeting frequency and firm performance

This study provides two control variables which are the size of the firm and also leverage. Frank and Goyal (2003) and Ramaswamy (2001) suggested that firm size would also influence firm performance. On the other hand, leverage might influence firm performance through the monitoring by the debt holders. The dependent variables of this study are the firm performance represented by Return on Asset (ROA), Return on Equity (ROE) and Earning per Share (EPS).

The objective of this study is to examine the relationship between the characteristics of board of directors and board meeting frequency towards firm performance. Employing Mashayekhi and Bazaz (2008) model, board characteristics are comprised of the number of board of directors (BSIZE), proportion of independent directors on the board (BOUT), CEO duality (DUAL) that indicates whether the CEO is also holding the position of the chairman, and the existence of directors on the board who are institutional investors (BIN). However, for this study, we excluded two characteristics which are CEO duality and institutional directors. The study substituted these two characteristics with other three independent variables which are multiple directorship, senior government officer and board meeting frequency.

This study uses multiple regression analysis (MRA) to examine the relationship between the independent variables and firm performance. There are three models representing each performance variable namely ROA, ROE and EPS. The following are the regression models used for testing Hypotheses 1-5:

$$ROA = \alpha_0 + \alpha_1 BSIZE + \alpha_2\ BOUT + \alpha_3\ MULT + \alpha_4\ SGO + \alpha_5\ BMEET + \alpha_6\ SIZE + \alpha_7\ LEV + \epsilon \quad (1)$$

$$ROE = \alpha_0 + \alpha_1 BSIZE + \alpha_2\ BOUT + \alpha_3\ MULT + \alpha_4\ SGO + \alpha_5\ BMEET + \alpha_6\ SIZE + \alpha_7\ LEV + \epsilon \quad (2)$$

$$EPS = \alpha_0 + \alpha_1 BSIZE + \alpha_2\ BOUT + \alpha_3\ MULT + \alpha_4\ SGO + \alpha_5\ BMEET + \alpha_6\ SIZE + \alpha_7\ LEV + \epsilon \quad (3)$$

Where;

EPS	=	Earnings per share for GLCs
ROA	=	Return on Assets for GLCs
ROE	=	Return on Equity for GLCs
BSIZE	=	Board size of GLCs
BOUT	=	Board independent of GLCs
MULT	=	Multiple directorships in board of GLCs
SGO	=	Senior Government Officer in board of GLCs
BMEET	=	Board meeting frequency of GLCs
SIZE	=	Size of GLCs
LEV	=	Leverage of GLCs

4. RESULTS AND FINDINGS

From the Table 2, only the independent variable of board meeting frequency has the significant relationships towards the three models being tested.

Table 2: Regression results for relationships between corporate governance mechanisms and firm performance

	Model 1 (ROA)			Model 2 (ROE)			Model 3 (EPS)		
	Coeff.	t-ratio	sig.	Coeff.	t-ratio	sig.	Coeff.	t-ratio	sig.
BSIZE	0.067	0.688	0.493	0.132	1.269	0.207	-0.108	-1.236	0.219
BOUT	0.089	1.016	0.311	0.146	1.535	0.128	-0.042	-0.533	0.595
MULT	-0.041	-0.467	0.641	-0.134	-1.409	0.162	0.099	1.253	0.213
SGO	0.010	0.118	0.906	-0.018	-0.197	0.844	-0.056	-0.726	0.469
BMEET	-0.463	-5.277**	0.000	-0.431	-4.547**	0.000	-0.344	-4.391**	0.000
FSIZE	0.108	1.098	0.274	0.097	0.923	0.358	0.495	5.450**	0.000
LEV	-0.201	-2.408*	0.018	0.017	0.193	0.848	-0.265	-3.601**	0.000
Dummy	0.056	0.711	0.478	0.055	0.643	0.521	0.060	0.847	0.399
R-square		0.266			0.185			0.401	
Adj R-square		0.219			0.130			0.363	
F-value		5.628**			3.367**			10.620**	
n		133			128			136	

Note: **Indicates significance at the 0.01 level (2-tailed).
**Indicates significance at the 0.05 level (2-tailed).

The result suggests that the less board meetings held by the GLCs, the better the performance of the GLCs. This implies that more board meetings are associated with more costs and this will have an impact to the firm value (Brick and Chidambaran, 2010). Thus, the board in GLCs limits the frequency of board meetings to control and avoid unnecessary costs and compensate that with a more quality and comprehensive discussion each time they meet. The significant negative relationship between board meetings frequency and firm performance is consistent with Vafeas (1999) and Adams (2005).

5. CONCLUSION

The objective of this study is to examine the relationship of all the explanatory variables towards the performance of the GLCs. Based on the findings, only board meeting frequency (H1e) support all the three performance models. This suggests that the board meetings in GLCs are properly planned to maximize the output of the meetings. Proper plan board meetings will reduce the frequency of board meetings and hence will cut unnecessary costs associated with the meetings. This will have a good impact towards firm value and also firm performance although there is no optimum number for the amount of meetings recommended to be held by the GLC Transformation program.

There are few reasons that might be the factors in contributing the result of this research. First of all, the size of the sample is small and thus the result cannot be generalized to all GLCs in Malaysia. An increase in the sample size might be helpful in giving positive impacts on the representative power of the results. Secondly, the period of the study only covers a small part of the progress of the GLC Transformation program (first and second phase). There are four phases namely Mobilisation, Diagnosis and Planning (Phase 1), Generate Momentum (Phase 2), Tangible Results (Phase 3) and Full National Benefits (Phase 4). These phases are expected to be fully realized in the year 2015. Examining using a longer time period may result in different findings. In this case, the results may not be represented wholly as the time period only covers two phases out of four phases. Finally, since the current result shows that board characteristics do not has any impact towards GLCs performance, the inclusion of other corporate governance variables in future research, such as ownership concentration, insider shareholding, audit committees, and foreign ownerships might improve the regression model and its reliability.

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