The impact of corporate governance on share price among Malaysian listed companies: Proposed theoretical framework

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Abstract - Asian crisis was a perfect lesson for Malaysian government to make a decision to adopt corporate reform. This reform is actually declared in the code of corporate governance. The main objective of this study is to advance the international corporate governance research agenda by examining the impact of corporate governance on share price within the Malaysian context. Considering the mixed views on the impact of corporate governance, this study will examines three elements of corporate governance namely: leadership Structure, Independent Director, and Audit Committee. The sample of this study will be 300 companies listed under the main market of bursa Malaysia from 2008 to 2012. The data will be analyzed using three statistical techniques; Anova, simple and multiple regression technique and path analysis. It is hoped that the results of this study will contribute to previous academic studies as well as decision-makers in Malaysia to update the real impact of corporate governance in Malaysia.

Keywords - Corporate governance; share price; Malaysia.

1. Introduction

Over the past two decades, corporate governance (CG) has attracted a considerable number of public interest due to its obvious significance for firms’ development performance [1]. The need for good governance is evident by various reforms and standards developed not only at the country level, but also at an international level (e.g., the Sarbanes-Oxley Act in the US, Combined Code in the UK, and the Organization for Economic Development [OECD] Code). Typically, in the economic literature, corporate governance elements are considered as the institutions to mitigate the effects of agency problem existing in the organizations.

Bhattacharyay (2004), stated that there are seven major problems associated with Asian developing countries in strengthening corporate governance including (1) excessive government intervention; (2) highly concentrated ownership structure; (3) weak external discipline in the corporate sector; (4) weak legal systems and regulatory framework; (5) lack of quality information; (6) lack of investors’ protection; and (7) lack of developed capital market that undermine the effectiveness of corporate governance mechanism employed in Asia.

In Malaysia, corporate governance reform has started prior to Asian financial crisis in year 1997-1998. The crisis attracted considerable criticisms to corporate governance due to the failure of large companies that drove Malaysian stock market to fall [3]. For example, the Malaysian stock market melted sharply by 79.3% from the peak of 1271.57 points in February 1997 to the bottom of 262.70 points on the first of September 1998 [4].

After the Asian crisis, Malaysia has taken various steps to improve corporate governance standards of the country. The first initiative was the establishment of a high level financial committee on corporate governance under the Ministry of Finance in 1997 [5]. In the first report in 1999, the committee concluded that corporate governance system in Malaysia is in a weak position [6]. In 2001 the Code stated that all board of directors in Malaysian listed companies should have at least 2 persons or 1/3 of the independent directors. The requirement is mainly to protect shareholders interest. In addition, existed sufficient number of independent directors is essential to ensure the balance between power and authority [7].

To enhance board effectiveness and audit committees in 2007, the code has been revised. In 2012, the Code further explains the board's role in supplying leadership, strengthening board performance through enhancing its independence as well as its composition [8].
II. Literature review

A. What is corporate governance?

Corporate governance has various definitions; however, the MCCG (2012) definition, as an example, is “the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value, whilst taking into account the interests of other stakeholders” [8].

B. Corporate governance and share price

A number of studies have discovered the impact of corporate governance on share price in various countries. However, the results were inconclusive. For example, Gurgul and Majdosz (2007) discovered by using data from the Warsaw Stock Exchange between 2000 and 2005 that stock market reaction has positive effect before the announcement of board members resignation release and negative effect over the following six-day-period. In Turkish market, Arslan, Karan, and Ekisi (2010) did not find from their study for the period of 1995 to 2006 any impact on stock market performance when the position of CEO and chairman is combined. In the US, “Reference [11]” found that a large number of the US companies from 1990 to 2001 corporate governance (measured by board independence) has negative impact on stock price in formativeness.

A study conducted by Ferreira, Ferreira, and Raposo, (2011) among 96 listed firms in Saudi from 2006 to 2008, discovered that corporate governance measured by leadership structure has an inverse relationship with stock price performance. Another study found by measuring 432 major American corporations for the period 1997 to 2006 that there were no increases in stock value for the companies which had more outside directors and their CEOs were separated from the chairmen position [13]. A recent study using 1451 firms by collecting weekly returns from CRSP from the period of 2002 to 2009 shows that the percentage of independent directors on the audit committee has a negative relationship with stock price crashes [14]. Finally, the other recent study carried out to discover the effect of expertise of Audit committee on companies’ share price listed on the KSE 30 index for the year 2009 and 2010, result of sixty (60) observations analyzed was that CEO Duality, board independence, and expertise of audit committee are considerably associated with the share price of a company [15].

III. Corporate governance in Malaysia

A. Leadership structure

Leadership is “the highest ranking executive in a company whose main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, acting as the main point of communication between the board of directors and the corporate operations”[18].

The Malaysian Code on Corporate Governance (2001) and its revised edition of (2007) have been highly recommended to split the roles of CEO/chairman and not to be held by one person [19]. However, a recent study conducted in Malaysia found that the influence of corporate governance measured by leadership structure has no much impact on the financial performance for the period 2009 to 2011, although various reforms [20]. Another study carried out by Fooladi, Abdul Shukor, Saleh, and Jaffar (2013) find in using 400 companies listed on Bursa Malaysia that CEO duality has a negative impact on firm performance.

B. Independent Director

Independent directors means a group of individuals who are elected by the shareholders, not a member of management or employed by the company or its affiliates, not have a close relationship to the company or its management through significant economy or family, and have no material interests in a company [22].

The listing requirements of bursa Malaysia under chapter 15 “corporate governance” - part B “Directors” determine to have at least two directors of one-third of the board, whichever is higher, much be independent [23]. Various studies in Malaysia discovered that independent directors have influence on firm performance. For example, by using 300 Malaysian public listed companies, this study revealed that board independence has a negative relationship with firm performance [24]. However, the same study that conducted by Fooladi, Abdul Shukor, Saleh, and Jaffar (2013) shows that the relationship between board independent and firm performance in Malaysia is positive.

C. Audit Committee

The audit committee term is explained as “a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer”. The main substance of an audit committee's function is its independence, that is why this committee is composed of members of the board of directors, majority of whom are independent, to conduct their roles efficiently [1].

The revising of Malaysian code in 2007, states that all members of the audit committee should no longer comprised of executive directors. Moreover, recently in 2009, the amended Bursa Malaysia Listing requirement provides that the audit committee members must be at least three people, non-executive directors, majority of them are independent directors, and one of them is at least a member of the Malaysia Institute of Accountants (MIA) or has three years of experience [25]. Different studies in Malaysia revealed that audit committee has influence firm performance. For examples, a study examining 221 Malaysian listed firms from 2002 to 2004 discovered that audit committee promoted firm performance [26]. Similarly, the result of the same study conducted by Fooladi, Abdul Shukor, Saleh, and Jaffar (2013)
reveals that audit quality has a significantly positive effect on firm performance in Malaysia.

### IV. Theoretical framework and methodology

A quantitative research design is adopted in this paper to examine the impact of corporate governance on share price in Malaysia. The reason of chosen this method is because data will be totally reliable on secondary data method. Based on the Malaysian code of corporate governance and later revision, the system of corporate governance in Malaysia has to be improved in many aspects including: Leadership, Independent Director, and Audit Committee. This paper will focus only on these three elements of corporate governance although there are other elements of corporate governance to be considered. The general aim of this paper is to examine the impact of corporate governance elements on share price among Malaysian listed companies; while the specific aims are (1) to examine the impact of leadership structure on share price among Malaysian listed companies. (2) To examine the impact of independent directors on share price among Malaysian listed companies. (3) To examine the impact of audit committee on share price among Malaysian listed companies.

The key point of this paper is to discover in which side this study will stand and support whether Leadership, Independent Director and Audit Committee have either positive or negative impact on share price in Malaysia. Figure 1 demonstrates the research model of this paper.

![Figure 1: Research Model](image)

The independent variable in this paper is corporate governance which will be measured by using three factors: Leadership, Independent director, and Audit committee. For the measurement of Leadership: if the position of CEO is separated from chairman in a company, Leadership in this case will take number 0. However, if one person holds the top position, Leadership will take number 1. The number of independent director on each company board will be the measurement of Independent Director. Finally, Audit committee is measured by the total number of audit committee in each company. The dependent variable of this paper is share price. Although this variable can be measured by collecting daily, weekly, monthly, quarterly and yearly price, this study will focus only on the yearly price.

The scope of the study will be companies that listed on Bursa Malaysia. The study sample will be selected based on stratified random sampling. This sampling method will ensure all companies of the population are equally represented in the sample. According to Krejcie and Morgan (1970), sample size of around 300 companies is confirmed based on the current population as of November 2013.

This paper will rely on secondary data method to collect the data from 2008 to 2012. Data for corporate governance components will be collected from companies’ annual reports. The data of share price will be taken from bursa Malaysia databases. This paper will employ Statistical Package for Social Sciences (SPSS) to analyze the collected data. Three statistical analysis techniques will be performed for this study; Anova, simple and multiple regression to discover the impact of corporate governance on share price.

### V. Research Contribution

This research will add a significant value to the literature since it gives a comprehensive perspective and insights of the corporate governance roles in influencing share price in Malaysia. This paper is considered to be one of the recently academic studies that address the impact of corporate governance on share price.

The econometric results of this study will have significant support to policy-makers in Malaysia particularly with regard to the extent of compliance of companies on the application of the Code of Corporate Governance, and how this is important to develop the financial market in Malaysia. The policy-makers in Malaysia can also discover the proportion of the impact of corporate governance on share price.

### VI. Reference


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