The Impact of Internal Corporate Governance on Firm Performance: Empirical Evidence from Bangladesh, Malaysia & Singapore

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ABSTRACT

Internal Corporate governance refers to the controlling mechanism of various internal actors of a firm. The aim of the study is to explore the impact of internal corporate governance (CG) mechanism on firm performance in three Asian countries namely Bangladesh, Malaysia, and Singapore. Results show that Board Size, Board Independence and CEO Duality have impact on firm performance. Though the impact of CG on firm performance is significant in Singapore, the impact is not significant in Bangladesh and Malaysia. These findings of the study have significant implications to public policy makers and corporate managers to understand the evolution and effectiveness of internal CG practices in different Asian countries.

Key Words: Internal Corporate Governance, Firm Performance, Board of Directors

INTRODUCTION

Asian Financial Crisis 1997/98 (AFC) and the subsequent corporate scandals such as Enron, WoldCom, AIG had created a concern about the effectiveness of Corporate Governance (CG) to protect shareholders' interests. Specifically, scholars had identified weak CG practices in Asia is one of the major reasons of AFC, and suggested for different CG reforms. Responding that CG debate, different Asian countries initiated to reform their CG environment and enacted CG rules and regulations. However, firms have discretionary to adopt CG practices after a certain point. Therefore, adoption of internal CG practices of firms in different countries with different institutional frameworks is a worthy issue to understand its effectiveness.

This study is an attempt to investigate the effectiveness of internal corporate governance mechanism to affect the firm performance in the listed companies of three stock exchanges of three different countries namely- Bangladesh, Malaysia and Singapore. Among these three countries, according to Asian Corporate Governance Association (ACGA) which monitors CG practices of Asian firms and ranks the countries according to the CG practices and its impact on respective markets,Singapore is in the top position in implementing good CG mechanism in its corporations. Malaysia is also in top 5 in the corporate governance indexof Asian countries. On the other hand in every aspect of corporate governance mechanism Bangladesh is far behind from Malaysia and Singapore. Given this scenario, this study has tried to find the relationship of internal CG and firm performance in three different corporate environments. Successful completion of this study has helped to know whether there is any relationship between different internal CG mechanisms with firm performance in different institutional environment.

The remaining part of the paper is organized as: second section discusses literature review and developed hypothesis, third part explains methodology which follows the fourth part discussing finding and discussion of the results. The final part concludes the study highlight the implication and limitation of the study.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Corporate Governance

Recent corporate scandals in both parts of Atlantic have made the discussion of CG more important than ever (Aluchna, 2009). The definition of CG varies in different contexts or different countries (Solomon and Solomon, 2004). According to Jensen and Macline (1976) CG is a mechanism used by shareholders to control the self-motivated behaviours of agents (managers). Steiner & Steiner (2006) define CG as 'overall control' through which businesses formulate corporate objectives, strategies, and management structure to insure the interests of all stakeholders. The Cadbury Committee (Cadbury, 1992, p. 15) defines CG as ''the system by which companies are directed and controlled''. According to Cornelius (2005, p. 12) "corporate governance can be defined as the stewardship responsibility of corporate directors to provide oversight for the goals and strategies of a company and foster their implementation." It has also been defined by Keasey, Thompson and Wright (1997) to include ''the structures, processes, cultures and systems that engender the successful operation of the organisations.''

According to Shleifer and Vishny (1997) corporate governance is the way in which suppliers of finance to corporations assure themselves of getting a return on their investment. Gillan and Starks (1998) define corporate governance from broader perspective. They define CG as the system of laws, rules, and factors that control operational activities at a company. CG can be classified into two part namely internal CG and external CG (Jensen, 1993 and Gillan, 2006). The main internal mechanisms are ownership structure and board of directors. On the other hand external mechanism consists of mainly laws and regulations, market pressure, capital market, and media.

In this study focused has been given to internal CG specifically to the Board of Directors (board size, board independence and CEO duality). The rational of this focus is that internal CG ultimately controlled and maintained by Board and Board's effectiveness ultimately determines the firm value which is relatively apparent to general public and easier to measure.

Board Size

According to Singh and Davidson III (2003), size and composition of board may be a reflection of efficiency of the board. They also find that firm performance is higher with smaller boards which is consistent with Jensen (1993) and Liptop&Lorsh (1992). Mak and Yuanto (2002) in a study of the firms of Singapore and Malaysia also find negative relationship with board size and firm value (Tobin's Q). Carline, Linn and Yadav (2002) also find the negative relationship between board size and firm performance in UK firms. The study of Mishra, Randoy, &Jenssen, (2001) on the CG of family firms in Norway also confirm this negative relationship.de Andres et al. (2005) report a negative association between firm performance and board size (controlling for a number of additional factors) in 10 OECD countriesO'Connell & Cramer (2010) find a significant negative relationship between board size and firm performance. Conversely, Adam &Mehran (2002) find a positive and significant relationship between board

size and firm performance measured by Tobin's Q. On the other hand, Brewer III, Jackson III &Jagliani (2000) find no relationship between board size and firm performance.

Hypothesis I (H_1): There is a negative relationship between Board Size and firm performance**.**

Board Independence

Fama and Jensen (1983) explain that board outsiders (independent director) help to increase the firm's value by lending experience and monitoring services. Independent directors are supposed to monitor shareholders' interest and can be more effective in monitoring the firm managers (Hermalin and Weishbach, 1991). In addition, Brickley, Coles, & Terry, (1994), and Rosenstein & Wyatt (1990) also find that outside directors could improve board effectiveness and firm performance.

This evidence of positive impact of board independence on firm performance is further supported by McKnight and Mira (2003). They find a positive and significant relationship between outsiders' proportion and firm value as measured by Tobin's Q. Other empirical evidence regarding board composition towards performance finds that outside directors may increase the value of the firms through their evaluation of strategic decisions (Byrd and Hickman, 1992). O'Connell & Cramer (2010) find a significant positive relationship between board independence and firm performanceAgrawal and Knoeber (1996) find that board independence is in fact negatively correlated with performance. Haniffa and Hudaib (2006), Klein (1998), Mehran (1995) and Hermalin&Weishbach (1991) find no significant relationship between performance and outsiders' proportion on the board of directors as measured by Tobin's Q and ROA. de Andres et al. (2005) also fails to establish a statistically significant association between firm performance and board independence across a sample of OECD countries

Hypothesis II (H_2): There is positive relationship between Board Independence and firm performance

CEO Duality

Duality can be defined as a board structure control mechanism which may be explained as the same person serving as both the chief executive officer (CEO) and chairman of the board. The Cadbury Committee assumes the practice as unnecessary because it potentially provides one person with too much power in decision making (Cadbury, 1992). Previous studies analyzing the impact of duality on firm performance have been mixed.Vafeas and Theodorou (1998), and Brickley, Coles, & Jarrell, (1997) find no relation between CEO duality and firm value. Haniffa and Hudaib (2006) find that the duality role is not significant in relation to firm value as measured by Tobin's Q. However, the duality is found to be significant in a negative direction with firm performance as measured by return on assets (ROA). This evidence is supported by McKnight and Mira (2003) who find that duality has a moderately strong and negative impact on quality values. In other words, firms where duality did exist performed poorly compared to those firms where the CEO did not occupy both positions.

On the other hand, Rechner and Dalton (1991) find that the firms where the CEO also serves as chairman have a higher ROE, ROI and profit margins. This argument is supported by Alexander, Fennell, & Halpern (1993) who find that CEO duality is positively related to firm market value. This is because non duality dilutes the top management power and increases the probability of conflict between the board of directors and management.

Hypothesis III (H_3): There is a negative relationship between CEO Duality and Firm Performance.

METHODOLOGY

Sample & Data

This study is based on the three samples selected from the top three indices of the selected stock exchange of the selected countries. The indices are DSE 30 (Dhaka Stock Exchange of Bangladesh), STI - Straits Times Index (Singapore Stock Exchange) and FBMKLCI - FTSE Bursa Malaysia Kuala Lumpur Composite Index (Bursa Malaysia- previously known as Kuala Lumpur Stock Exchange). In total 90 firms, (30 from each country) have been chosen as sample.The rationale of selecting 30 forms from each country is that we only wanted to work with the firms which were included in the indices of respective stock exchange as an index is formulated so that it reflects the whole exchange clearly. And as DSE 30 index includes only 30 firms, we found it convenient to select 30 firms from each of the other two stock exchanges to create a sample balance. Each of the selected countries is a common-law country which implies that the sources of corporate governance environment of all three countries are similar. Moreover, all three countries were affected by the by the Asian Financial Crisis and lack of proper CG practices in firm level was considered one of the main reason of the crisis, which properly justifies the inclusion of the samples from the three said countries.
Main source of data for this study is the published annual reports of selected firms for the period of 2011-2012. Most of the data was collected from these annual reports. Besides this, company websites as well as websites of the three stock exchanges were used to collect the additional data.

Research Model

This study focuses on relationship between Internal CG mechanisms and firm performance. For performance measurement, two proxy variables have been incorporated in the model and these are Return on Asset (ROA) and Return on Equity (ROE). Three dependent variables are Board Size (BSIZ), Board Independence (BIND) and CEO Duality (CEOD). Some control variables are also used in the model and these are Leverage (LEVRG), firm Age (AGE), and firm Size (FSIZ). Details about the variables could be found on the following tables:

Table I: Variables

Variable Label	Variables	Variable Definition
Dependent Variables		
ROA	Return on Asset	Net Income / Total Asset
ROE	Return on Equity	Net Income / Total Equity
Independent Variables		
BSIZ	Board Size	Total number of board members
BIND	Board Independence	% of independent directors
CEOD	CEO duality	'0' if CEO & Board chairman is same person, otherwise '1'
Control Variables		
LEVRG	Leverage	Book value of debt / Book value of equity
AGE	Listing time period	Number of years after listing in the exchange
FSIZ	Firm Size	Natural log of total asset

For running the Ordinary Least Square (OLS) regression, the following models have been specified for this study:

Model A:

$ROA = \alpha_i + \beta_1 FSIZ + \beta_2 BIND + \beta_3 CEOD + \beta_4 LEVRG + \beta_5 AGE + \beta_6 FSIZ + \varepsilon_i$

Model B:

$ROE = \alpha_i + \beta_1 FSIZ + \beta_2 BIND + \beta_3 CEOD + \beta_4 LEVRG + \beta_5 AGE + \beta_6 FSIZ + \varepsilon_i$

FINDINGS AND DISCUSSION

Descriptive Analysis

In Bangladesh average board size is 10.8 and median of 9.0 shows that 50% of the sample firms have average board size of 9.0 (table 2). Proportion of independent board member is 0.07 (7%) which indicates that board independence in Bangladeshi firms is very low comparing with other two countries. Range (0 to 0.17) also reveals that there is firm/firms without any independent director. Mean of CEO duality (0.95) tells that most of the firms do not have CEO duality. Average age of Bangladeshi firms is 25.90 and average leverage is 4.15 with a range of 0.26 to 12.96 which also indicates high level of variation in the riskiness of Bangladeshi firms. Variation in ROE is very high (range -0.14 to 3.98) with standard deviation of 86% than the variation of ROA (range -0.08 to 0.36) with standard deviation of only 11%.

Table II: Descriptive Statistics

	Bangladesh					**Malaysia**					**Singapore**				
Variables	**Mean**	**Med**	**SD**	**Min**	**Max**	**Mean**	**Med**	**SD**	**Min**	**Max**	**Mean**	**Med**	**SD**	**Min**	**Max**
ROA	0.12	0.09	0.11	-0.08	0.36	0.10	0.08	0.07	0.01	0.32	0.08	0.08	0.04	0.01	0.18
ROE	0.55	0.29	0.86	-0.14	3.98	0.24	0.19	0.22	0.07	1.11	0.16	0.15	0.06	0.07	0.30
BODSIZ	10.8	9.0	4.7	4.0	22.0	9.0	8.5	1.8	6.0	13.0	10.6	11.0	2.1	5.0	14.0
BIND	0.07	0.09	0.06	0.00	0.17	0.43	0.41	0.13	0.25	0.63	0.57	0.60	0.13	0.31	0.75
CEODTY	0.95	1.00	0.22	0.00	1.00	0.90	1.00	0.31	0.00	1.00	0.90	1.00	0.31	0.00	1.00
COMSIZ	2.41	2.31	0.60	1.39	3.43	3.97	3.89	0.52	3.19	5.18	4.20	4.18	0.55	3.11	5.44
AGE	26	24	15	6	58	47	39	31	15	106	39	28	31	7	128
LEVRG	4.15	2.07	4.14	0.26	12.96	2.79	0.94	5.01	0.04	18.48	1.93	0.81	2.73	0.22	9.94

SD=Standard Deviation, Med= Median, Min= Minimum, Max= Maximum

For Malaysian firms, mean of board size is 9.0 with a median of 8.5. Mean of the proportion of board independence is 0.43 which indicates a moderate level of board independence in Malaysian firms. Mean of CEO duality is 0.90 which reveals most of the firms of the selected samples have different CEO and board chairman. Average leverage of the sample firms is 2.79 which vary from 0.04 to 18.48. ROA varies more widely than ROE over the samples.

Table II also presents the descriptive statistics of selected variables of the samples selected from Singapore. Mean reveals that average board size of the sample firms is 10.6. A median of 11.0 indicates 50% of the firms have average board size of 11.0. Mean of the proportion of independence directors in board is 0.57 which indicates a high level of board independence in Singaporean firms. Median (0.60) shows 50 % of the sample firms have 60% independent director in the board. Mean of CEO duality is 0.90 which tells us in most of the cases CEO and Chairman is different person. Mean of the leverage is 1.93 which varies from 0.22 to 9.94. Both ROA and ROE is stable with standard deviation of 0.04 and 0.06 respectively.

CORRELATION ANALYSIS

Correlation Analysis(Bangladesh)

Table III represents correlations among the key variables of the samples taken from Bangladesh. There is a significant negative correlation between BODSIZ and ROA which indicates that board size has significant negative impact on accounting based firm performance. BODSIZ has also negative relationship with BIND. A significant positive relationship between COMSIZ and BODSIZ reveals that bigger company has larger board size**.** CEODTY has negative correlation with age. There is a significant positive relation between board size and leverage indicates larger board trends to take higher risk. COMSIZ also has a positive relation with LEVRG. On the other hand BIND has negative relationship with LEVRG.

Table III: Correlation (Bangladesh)

	ROA	ROE	BODSIZ	BIND	CEODTY	COMSIZ	AGE	LEVRG
ROA	1							
ROE	0.69	1.00						
BODSIZ	-0.43*	-0.08	1.00					
BIND	0.07	0.01	-0.46*	1.00				
CEODTY	0.04	0.10	0.14	0.28	1.00			
COMSIZ	-0.24	-0.20	0.67**	-0.32**	-0.23*	1.00		
AGE	0.39**	0.44*	-0.17	-0.05	0.05	-0.01	1.00	
LEVRG	-0.14	0.41	0.65*	-0.28*	0.20	0.38*	0.25	1.00

**Correlation is significant at the 0.01 level (2-tailed); ** Correlation is significant at the 0.05 level (2-tailed)*

Correlation (Singapore)

Table IV is a representation of the correlation among the key variable used in the study from the sample of Singapore. Results show BODSIZ has negative correlation with BIND but a significant positive correlation with CEODTY and COMSIZ. BODSIZ also has negative correlation with firm performance (ROE and ROA) which is also same for COMSIZ. LEVRG also has negative relation with firm performance.

Table IV: Correlation (Singapore)

	ROA	ROE	BODSIZ	BIND	CEODTY	COMSIZ	AGE	LEVRG
ROA	1.00							
ROE	0.76	1.00						
BODSIZ	-0.05	-0.02	1.00					
BIND	0.01	0.16	-0.34*	1.00				
CEODTY	-0.03	-0.06	0.51**	0.18	1.00			
COMSIZ	-0.67*	-0.38*	0.34*	0.12	-0.04	1.00		
AGE	-0.11	0.02	-0.06	0.16	0.17	0.33	1.00	
LEVRG	-0.63**	-0.23**	0.29	0.08	0.08	0.72	0.32	1.00

**Correlation is significant at the 0.01 level (2-tailed); ** Correlation is significant at the 0.05 level (2-tailed)*

Correlation (Malaysia)

Correlation among key variable for the sample taken from Malaysia is presented in table 5. From the table we can see that BODSIZ has significant negative relation with both ROA and

BIND. On the other hand BIND has positive correlation with CEODTY and negative correlation with ROA. COMSIZ has negative correlations with ROA, ROE, BIND and CEODY but a positive correlation with BODSIZ. AGE has negative relation with both the performance measures ROA and ROE. On the other hand LEVRG has negative relation with ROA but positive relation with BODSIZ COMSIZE and AGE.

Table 5: Correlation (Malaysia)

	ROA	ROE	BODSIZ	BIND	CEODTY	COMSIZ	AGE	LEVRG
ROA	1.00							
ROE	0.77	1.00						
BODSIZ	-0.24*	-0.17	1.00					
BIND	0.08	-0.01	-0.24*	1.00				
CEODTY	-0.26*	-0.01	0.18	0.46*	1.00			
COMSIZ	-0.31**	-0.21**	0.24**	-0.29**	-0.34*	1.00		
AGE	-0.21*	-0.24**	0.20	0.00	0.15	0.11	1.00	
LEVRG	-0.43*	0.06	0.30*	-0.14	0.15	0.51**	0.29**	1.00

**Correlation is significant at the 0.01 level (2-tailed); ** Correlation is significant at the 0.05 level (2-tailed)*

REGRESSION ANALYSIS

Regression result (Bangladesh)

Model A:

Table VI is a representation of regression result between ROA and other independent variables from the samples of Bangladesh. R^2 (0.262) tells that the model only explains 26.2% of the variation measured by ROA. The regression result shows that there is negative but insignificant relationship between board size and ROA (Beta = -.016, P = 0.199). It also shows that board independence is negatively and insignificantly associated with ROA (Beta = -.0393, P = 0.472). Results indicates a positive but insignificant relation of CEO duality with ROA (Beta = 0.105, P = 0.476). So, none of the hypothesis can be accepted based of the given regression result.

Table VI: Regression Result for Bangladeshi Firms

	Model A			Model B		
	Beta	t value	p value	Beta	t value	p value
Constant	0.088	0.465	0.65	1.38	1.01	0.33
BODSIZ	-0.016	-1.353	0.199	-0.04	-0.42	0.68
BIND	-0.393	-0.742	0.472	0.45	0.12	0.91
CEODTY	0.105	0.733	0.476	-0.33	-0.32	0.76
COMSIZ	0.033	0.488	0.633	-0.45	-0.93	0.37
AGE	0.002	0.802	0.437	0.01	0.99	0.34
LEVRG	0.002	0.246	0.809	0.13	1.95	0.07
F Value		0.329			1.699	
P Value		0.432			0.199	
R^2		0.262			0.44	
Adjusted R^2		0.019			0.181	

Model B:

Table VI also shows the regression result between ROE and other independent variables from the samples of Bangladesh. R^2 (0.440) tells that the model explains44% of the variation measured by ROE. The regression result shows that there is negative but insignificant relationship between board size and ROE (Beta = -.04, P = 0.68). It also shows that board independence is positively and insignificantly associated with ROE (Beta = 0.45, P = 0.91). Results indicates a negative but insignificant relation of CEO duality with ROE (Beta = -0.33, P = 0.76). So, neither of the hypothesis can be accepted based of the given regression result.

Regression result (Singapore**)**

Table VII: Regression Result for Singaporean Firms

	Model A			*Model B*		
	Beta	t value	p value	Beta	t value	p value
Constant	0.18	2.506	0.026	0.28	1.96	0.07
BODSIZ	0.018	3.622	0.003	0.03	2.71	0.02
BIND	0.165	2.755	0.016	0.31	2.54	0.02
CEODTY	-0.091	-2.995	0.01	-0.15	-2.53	0.03
COMSIZ	-0.076	-3.965	0.002	-0.12	-3.01	0.01
AGE	0.001	2.33	0.037	0	1.71	0.11
LEVRG	-0.005	-1.518	0.153	0	0.44	0.66
F Value		6.915			2.237	
P Value		0.002			0.105	
R^2		0.761			0.508	
Adjusted R^2		0.651			0.281	

Model A:

Table VII represents the regression result between ROA and other independent variables from the samples of Singapore. R^2 (0.716) tells that the model explains76.1% of the variation of performance measured by ROA. The F value of 6.91 and the P value of 0.002 tell that the model is very significant in explaining the associations between dependent and independent variables. The regression result shows that there is positive and significant relationship between board size and ROA (Beta = 0.018, P < 0.01). So, hypothesis 1 is rejected. It also shows that board independence is positively and significantly associated with ROA (Beta = 0.164, P = 0.016). So, hypothesis 2 is accepted. Results also indicates a negative and significant relation of CEO duality with ROA (Beta = -0.091, P = 0.01). So, hypothesis 3 is also accepted.

Model B:

Table VII is also a representation of regression result between ROA and other independent variables. R^2 (0.508) tells that the model explains50.8% of the variation measured by ROE. The F value of 2.237 and the P value of 0.105 tell that the model is significant in explaining the associations between dependent and independent variables.

The regression result shows that there is positive but significant relationship between board size and ROE (Beta = 0.03, P = 0.02). It also shows that board independence is positively and significantly associated with ROE (Beta = 0.31, P = 0.02). So, hypothesis 1 is fail to accept and hypothesis 2 is accepted. Results indicates a negative but significant relation of CEO duality with ROE (Beta = -0.15, P = 0.03). So, hypothesis 3is also accepted.

Regression result (Malaysia)

Model A:

Table VIII is a representation of regression result between ROA and other independent variables from the samples of Malaysia. R^2 (0.297) tells that the model only explain 29.7% of the variation measured by ROA. The F value of 0.917 and the P value of 0.513 tell that the model is very weak in explaining the associations between dependent and independent variables.The regression result shows that there is no relationship between board size and ROA (Beta = 0.00, P = 0.982) which is insignificant. It also shows that board independence is positively and insignificantly associated with ROA (Beta = -.091, P = 0.587). Results indicates a negative but insignificant relation of CEO duality with ROA (Beta = -0.097, P = 0.234). So, none of the hypothesis can be accepted based of the given regression result.

Table VIII: Regression Result for Malaysian Firms

	Model A			Model B		
	Beta	t value	p value	Beta	t value	p value
Constant	0.337	1.544	0.147	1.21	1.78	0.1
BODSIZ	0	0.023	0.982	-0.01	-0.43	0.68
BIND	0.091	0.557	0.587	-0.07	-0.15	0.89
CEODTY	-0.097	-1.248	0.234	-0.1	-0.39	0.7
COMSIZ	-0.044	-0.953	0.358	-0.17	-1.22	0.24
AGE	0.001	-0.285	0.78	0.001	-1	0.33
LEVRG	-0.003	-0.565	0.581	0.02	1.22	0.24
F Value		0.917			0.535	
P Value		0.513			0.773	
R^2		0.297			0.198	
Adjusted R^2		-0.027			-0.172	

Model B:

Table VIII is a representation of regression result between ROE and other independent variables from the samples of Malaysia. R^2 (0.198) tells that the model only explain 19.8% of the variation measured by ROE. The F value of 0.535 and the P value of 0.777 tell that the model is very weak in explaining the associations between dependent and independent variables.The regression result shows that there is negative but insignificant relationship between board size and ROE (Beta = -.01, P = 0.68). It also shows that board independence is negatively and insignificantly associated with ROA (Beta = -.07, P = 0.89). Results indicates a negative but insignificant relation of CEO duality with ROA (Beta = -0.10, P = 0.0.70). So, none of the hypothesis can be accepted based of the given regression result.

CONCLUSION AND IMPLICATION

The study explores the impact of internal corporate governance mechanism on the firm performance measured by ROA and ROE. Findings show that Board size and Board independence have negative relation with ROA and ROE of Bangladeshi firms, and the results are statistically insignificant. As a result we conclude that Board Size, Board Independence and CEO duality do not have any significant impact on the performance of Bangladesh. However, results shows the positive impact of Board size and Board independence on ROA and ROE of

firms in Singapore, and the impacts are statistically significant as well which suggests that internal CG mechanisms are effectively protect the interests of shareholders in Singapore.Moreover, the study finds the negative and significant impact of CEO duality on both ROA and ROE.However, like Bangladeshi firms, the findings of the study do not find any significant impact of internal CG mechanisms on any of the firm performance measures which indicates the lack of effectiveness of internal CG of Bangladeshi and Malaysian firms. Overall results of the study has important implication both to public policy makers, regulators and corporate managers to understand the effectiveness of CG mechanisms to protect shareholders' interest, and to formulate the policy to enhance the effectiveness of the CG mechanisms.

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