UNIVERSITI TEKNOLOGI MARA

CORPORATE GOVERNANCE AND TECHNICAL EFFICIENCY OF GOVERNMENT LINKED COMPANIES (GLCs) IN MALAYSIA: A STOCHASTIC FRONTIER APPROACH

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Thesis submitted in fulfillment
of the requirements for the degree of
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AUTHOR'S DECLARATION

I, declare that the work in this thesis was carried out in accordance with the regulations of Universiti Teknologi MARA. It is original and is the result of my own work, unless otherwise indicated or acknowledged as reference work. This topic has not been submitted to any other academic institution or non-academic institution for any other degree or qualification.

I, hereby acknowledge that I have been supplied with the Academic Rules and Regulations for Post Graduate, Universiti Teknologi MARA, regulating the conduct of my study and research.

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ABSTRACT

The performance of government linked companies (GLCs) has been the subject of scrutiny from both the perspective of academic research and policy formulation. With trade liberalization and increasing global market competition, GLCs efficiency becomes relevant to ensure sustainable economic growth not only for the Malaysian economy but to remain as key players in the regional and international markets. Corporate governance and how it has affected firm performance is a much-debated issue and there is voluminous literature aimed at understanding its role in maximizing firm profitability and market value. However, studies on its effects on the economic efficiency as another indicator for performance are still minimal.

This study's objectives are two folds: First, applying the Stochastic Frontier analysis with inefficiency effects model, in estimating technical efficiency of GLCs against selected foreign owned firms (FFs) as international benchmark. The analysis uses 31 GLCs and 15 FFs listed in *Bursa Malaysia* over a period between 2001 and 2012 (12 years). Second, applying a similar model to the 31 GLCs over the same period, and allowing inefficiency effects to be a function of a set of explanatory variables, that measures corporate governance mechanism.

The results indicate that the GLCs estimated efficiency levels have improved over time. The levels tend to slowly converge with the FFs that represent international standard. The top GLCs are found to have been catching up faster, although they are still below the frontier of best practice. Labour input, as measured by staff costs and other personnel expenses, is found to have a strong and negative relationship with output generation, suggesting overcapacity in human capital. Thus, this study recommends GLCs should embark on capital intensive, human talent and productivity driven policy to ensure investment in labour input would not lead to further inefficiency. When incorporating corporate governance mechanism to examine GLCs technical inefficiency, and controlling for firm sector and size, the results show government ownership, board remuneration, change in directors, and the independence of the Board Audit Committee are significantly important in explaining technical efficiency. While ownership structure and directors' incentive have been considered key corporate governance mechanisms to mitigate agency problem, this study finds that the effectiveness of the board is more relevant to address economic growth of the firm, thus supports the revised Malaysian Code of Corporate Governance, 2012 that propagate the importance of an effective Board of Directors.

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CHAPTER ONE
INTRODUCTION

1.1 RESEARCH BACKGROUND

The past decades saw a myriad of studies being undertaken concerning the issues on corporate governance. The collapse of world renowned corporations namely Enron and WorldCom in the late 1990s, and financial institutions namely Lehman Brothers and Fannie Mae in the late 2000s, not only saw the vulnerability of these firms during the financial crisis, but it also sparked widespread researches on corporate governance issues of which its mechanisms are thought to advocate good practices that may maximise investors' return. Ongoing financial crisis have also force governments of many countries to formulate effective corporate governance practices and implement guidelines to monitor firms against misuse of investors' funds and to ensure firms remain sustainably viable to face the challenges of global trade deregulation and competition. However, linking corporate governance to company performance and economic development is often regarded as weak (Tam & Tan, 2007).

In Malaysia, corporate failures and scandals have also been reported (e.g. Renong Bhd, Perwaja Steel Bhd) which also include several government linked companies (e.g. Malaysia Airlines Berhad, Proton Holdings Berhad). The lack of effective corporate governance is considered the main contributory factor towards the failure of these firms (Abdul Rahman, 2006). Companies that are linked to the government are also reported to be crowding out private investment (Menon & Ng, 2013). Currently, their economic dominance and monopolistic status are felt in almost all industries. Thirty percent of the total market capitalisation comes from listed firms that are somehow linked to the government. The main institutions listed under the finance sector in *Bursa Malaysia,* the Malaysian Stock Exchange Bourse, for instance, are controlled by the government[1].

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[1] Malayan Banking Berhad (Maybank) and CIMB Group Holdings Berhad (CIMB Group) are the largest listed financial institutions in term of market capitalization. In year 2012, Maybank's largest shareholder comprises *Permodalan Nasional Berhad*, a government linked Investment Company, through its ASB Unit Trust Scheme (40.38%), and Employee Provident Fund Board (13.97%). The