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Corporate Governance and Corporate Failure in the Context of Agency Theory

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Abstract

Corporate failure involves the cessation of trading or activity of a business, which is generally preceded by financial distress. Poor corporate governance has been identified as one of the factors that contribute to corporate failure. As an effort to prevent corporate failures, corporate governance reforms have been undertaken worldwide in an attempt to improve corporate governance. This is because a good governance structure would ensure that the roles and responsibilities of stakeholders and management would be well defined and strictly adhered to. This study aims to investigate the impact of corporate governance mechanisms on financially distressed companies which is proxied by PN4 and PN17 status (Practice Note 4 and Practice Note 17) of Malaysian public listed companies for a three year period from 1 January 2004 to 31 December 2006. In general, the aim of this study is to increase the understanding and to provide new empirical evidence of the impact of corporate governance attributes on the poor performance of companies in Malaysia and to test the robustness of the agency theory in the context of corporate governance. The research is concerned with three corporate governance mechanisms: board structure, ownership structure and internal control. The results of this study provide evidence that there is a significant negative association between CEO duality and financial distress condition. This implies that leadership structure affects the performance of companies. The findings suggest that CEO duality will reduce agency problem as the agent will act in his best interest since he can provide better strategic vision in the companies' goals and objectives. Other governance and internal control mechanisms identified in the study were found to be insignificant.

Keywords*: Corporate failure, Board structure, Ownership structure, Internal control, Agency theory.*

1. INTRODUCTION

The current global financial crisis which began in July 2007 started in the United States when US investors loss their confidence in the value of securitized mortgage in the country. This resulted in a liquidity crisis that prompted a substantial injection of capital into the financial markets by the United States Federal Reserve, Bank of England and the European Central Bank. The East Asian economy also collapsed in the second half of 1997, and Malaysia was amongst the worst affected countries in the region other than Indonesia, South Korea, and the Philippines (Zulkifli, A.Samad and Ismail, 2003). The repercussion of the Asian financial crisis has downgraded the confidence of market players in the region. The Malaysian corporate scene was also hit by several cases of accounting irregularities by listed companies. Megan Media Holdings Bhd, Nasioncom, Bumiputera-Commerce Berhad and Wimems Corp Bhd were among several Malaysian firms that announced some form of irregularities in their financial reporting. The highest profile case among these companies was that of Transmile Group Bhd. A special audit carried out on the company's accounts revealed that the revenue and pre-tax profits for the year 2004, 2005 and 2006 were overstated. A leading business magazine; The Malaysian Business (July, 2007) estimated probably around 10 out of 1,000 companies listed on Bursa Malaysia practice irregular accounting procedures in their financial reports. These financial crises resulted in substantial financial losses and an erosion of public confidence on companies. The most common cited reasons for such failure are the lack of internal control and poor corporate governance of the companies (Agrawal and Chadha, 2005; Charitou et. al, 2007 and Wang, 2006). This is because the fundamental strength of any institution lies in its governance structure. A good governance structure would ensure that the roles and responsibilities of stakeholders and management are well defined and strictly adhered to. More importantly, from the corporate governance perspective, the motives of management in operating the organization must be in the best interest of its stakeholders.

This study will establish whether corporate governance attributes are associated with a company's financial failure or distress condition which is proxied by PN4 and PN17 status (Practice Note 4 and 7) of Malaysian Public Listed companies. The effect of corporate governance structures on financially distressed firms will be examined in relation to board structures, various elements of ownership structure and internal control mechanisms. Board composition with high representation of independent non-executive directors is expected to monitor managerial actions and exert pressure on managers to improve their performance. Corporate ownership structure is expected to influence the performance of companies. It is because share holding structure is related to corporate performance and to solve the agency problem, the company director's interest must be aligned with shareholders' interest. In addition, a sound internal control mechanism is expected to limit fraud and irregularities in the company's operations which in turn will improve performance. The audit committee plays important roles in monitoring company's performance and indirectly in a better position to protect shareholders' interest.

Thus, this study extends the existing literature on corporate governance relationship with company's distressed condition. The broad aims of this study are to a) increase understanding and provide new empirical evidence of corporate governance attributes on the poor performance of companies as represented by PN4 and PN17 status (Practice Note No. 4 and 17/2005) and b) to test the robustness of theories that have been applied in the studies on corporate governance specifically agency theory. To achieve these aims, a conceptual model and a number of hypotheses are developed. The hypotheses will be tested using various statistical analyses with the aim of achieving the following specific objectives, a) to provide evidence of the relationship between board structure (board independence and CEO duality), corporate ownership (CEO ownership, executive director ownership and family ownership) and internal control mechanism (audit committee independence and financial expert) and company's financial distressed condition and b) to draw inferences from the results about the influences of corporate governance attributes and financially distressed firms.

2. LITERATURE REVIEW

2.1 Agency theory and corporate governance

Agency theory has been widely used in empirical research published on the subject of board of directors and firm performance. As the firms' size becomes bigger, shareholders may lose effective control of the corporation. Therefore, corporate governance problems may arise where two parties are involved i.e. directors as agents and shareholders as principals. Due to the separation of ownership from control, the shareholders are unable to engage in management and it is the responsibility of the board to represent the shareholder's interests. However, there is no substantial reason to believe that the directors will always act in the shareholders' best interest (Jensen and Meckling, 1976). The shareholders (principals) interest can be compromised if directors maximize their self interest at the expense of organizational profitability. In an agency perspective, agents (directors) cannot be trusted and therefore monitoring mechanism are essentials to overcome the possible conflict of interest between directors and shareholders. Thus, it is critical that organizations have boards of directors that are independent of management influence in order to achieve maximum performance (Muth and Donaldson, 1998). Failure of firms could also occur as a result of dysfunctional corporate internal control system.

2.2 Financial distress condition

According to Fehle & Tsyplakov (2005), a firm is in financial distress when the firm's leverage is above a critical level and the cash flow cannot cover debt payments. Financial distress can lead a firm into reorganization or other situations in which the firm faces direct legal costs or even liquidation of assets. As an effort to ensure only companies with good financial standing continued to be listed on the board, Bursa Malaysia introduced a category for companies that are financially distressed. Prior to 2005, companies that are financially distressed were governed under the Practice Note 4/2001 of the Listing Requirements (PN4/2001). PN4 or Practice Note (4) category was introduced by KLSE in February 2001. PN4 was issued in relation to Clause 8.14 of the Kuala Lumpur Stock Exchange (KLSE) listing requirements for companies listed on its main board and second board. Bursa Malaysia will take action against companies for any non-compliance with the clause (Practice Note (PN) No. 4/2001). However starting from 3rd January 2005, Clause 8.14 KLSE Listing Requirement was replaced with new paragraph 8.14C and Practice Note 4/2001 with Practice Note No.17/2005 Bursa Malaysia Listing Requirement (BMLR). It was an effort by Bursa Securities to further improve and strengthen the quality of companies listed on the exchange. The PN17/2005 sets out the new criteria for financially distressed companies, the requirements that must be complied with by companies affected by the PN17/2005 and the actions that may be taken by Bursa Malaysia against PN17 companies.

Prior researches have been conducted to identify the causes that contributed to companies to experience financial distress. Whitaker (1999) argued that more companies enter financial distress as a result of poor management than as a result of economic distress. He found that 77% of the firms were poorly managed and 47% of sample firms were economically distressed before being financially distress. Sawandi et al (2005) confirm that there are four primary financial factors that contributed to financial distress. The factors are debt where doubtful debt and bad debt is higher, loss in investment, impairment and write off of plant, property and equipment and finance cost. Six main non financial factors that contribute to financial distressed were fraud, non compliance and potential breaches, poor internal control and product failure. The study also indicates that the contributory factors to financial distress is the Asian financial crisis in 1997 where weaknesses in corporate system, the internal control system and corporate governance process were the main issues that arose from the crisis.

2.3 Board structure and company's performance

Mak and Li (2001) view the internal control of the board of directors as important mechanism for good corporate governance. This is because boards can be effective mechanism to monitor top management on behalf of dispersed shareholdings. Boards effectuate management appointment, dismissal, suspensions and rewards. Managers may be disciplined by the governance structure of the firms, in particular the structure and characteristics of the boards. Boards have internal governance and monitoring role to discipline or remove ineffective management teams (Barnhart et al., 1994). Boards monitoring quality can indeed improve the quality of the managers' decisions (Monks and Minow, 2004).

It can be concluded that the board of directors should fulfill three main roles. Firstly, it serves as the primary mechanism for monitoring management's behavior. Secondly, it acts as an institutional role that provides a link between an organization and its environment and its resources providers. Lastly, it has to ensure that there is a satisfactory framework of reporting on internal financial controls and regulatory compliance.

2.4 Board independence

The board independence is associated with the number of outside directors in the board. Adam and Mehran (2003) suggest that increases in the proportion of outside directors on the board should increase company's performance as they are more effective monitors of managers. It is consistent with Byrd et al. (2004) that highlight the survival of firms during a crisis due greater proportion of independent directors in the board. Bursa Malaysia listing requirement require at least one third of the board should comprise of independent directors. The term independent as prescribed by the listing requirement and the MCCG (2000) refers to independent from management and independence from the significant shareholders.

2.5 CEO duality

Duality role is referring to when the CEO is also the chairman of the board. CEO duality helps in decision making as it will concentrates on company goals and objectives hence will make a rapid execution of organization's operational decisions. It may also lead to improved performance resulting from clear unfettered leadership of the boards Studies in CEO duality and firm performance among Malaysian listed companies by Abdullah (2004) reveals that majority of the CEO and the chairman position were held by the different individual. Abdullah (2004) also finds that CEO duality have no significant difference in company's performance. The study was confirmed by Abdul Rahman (2009). However, it is very important to consider the MCCG (2000) recommendation which there should be clearly accepted division of responsibility at the head of company in order to ensure a balance of power and authority, therefore no one individual has unfettered power of decision.

2.6 Ownership structure and company's performance

Ownership structure is an important factor in shaping the corporate governance system in most countries. It determines the nature of the agency problem whether the dominant conflict is between managers and shareholders, or between controlling shareholders or minority shareholders. Consequently, it is necessary to explain the corporate control of particular firms at a different level. Study on ownership can be explained by type of ownership and the ownership concentration. The type of ownership can be explained by individual, institution, state, foreign and managerial ownership. The importance of ownership concentration was recommended by Schleifer and Vishny (1997) as one of the key determinants of corporate governance. Large shareholders often referred as block shareholders can benefit the minority shareholders because of their power and incentive to prevent expropriation (Mitton, 2002). However, these controlling shareholders may also pursue objectives that are inconsistent with those of minority shareholders (Morck et. al, 1988).

2.7 CEO and executive director's ownership

Equity ownership by managers is one of the tools that can potentially reduce agency problems and increase the value of the firm. A significant equity ownership by managers can align their interest with those of outsider shareholders so that management has the incentive to pursue value maximizing behavior. Han and Suk (1998) find the level of managers ownership is positively related to firm performance. In this study they used stock returns as the measurement of performance. Their results also suggest that as managers' ownership increases, their interest coincide more with those of the outside shareholders. However, when managers own a substantial portion of the equity in a firm, they may feel well-established and they may not always pursue value maximizing behavior (Morck et al., 1988). Managers may act for their own benefit such as to design an excessive remuneration package or to pursue any decision that will benefit them but not to other shareholders. Even worse, they may be able to retain their job position even though they should be replaced. On the other hand, managers' excessive ownership will harm firm's performance due to managerial entrenchment.

2.8 Family ownership

A discussion on family-controlled firms from the perspective of corporate governance is crucially important. This is based on assumption that family shareholders are widely perceived as the owners and residual claimants who control firms that largely belong to their own family. Family shareholders are believed have very strong incentive to monitor firm's operation and maximize firm performance. They also tend to have a long-term view of their business, employees, customers, and other important stakeholders, which seems to encourage the efficiency of their work. In addition, family shareholders are more conscious of their firm's performance as it effects their family reputation and their standing in the society (DeAngelo and DeAngelo, (1985). McConaughy et al. (2001) examine the link between family ownership and firm performance from 1986 through 1988. The performance, as measured by market-to-equity ratio and stock returns, of firms with family ownership is compared with that of control groups, which consist of firms with non-family ownership and firms with closely held ownership. The results in their study suggest that firms with family ownership have higher stock market returns than firms with non-family ownership or closely held ownership. He also found that family controlled firms have higher market-to-book equity ratio than non-family controlled firms matched by size, industry and percentage of managerial ownership.

2.9 Internal control

As discussed earlier, most of the reasons for corporate failure are due to governance failure where management fails to monitor the business operation through the internal control (Samad, 2005; Sulaiman and Ali, 2005 and Whitaker, 1999). One of the important duties of the board of directors is to monitor and evaluate management activities. Boards are elected by the shareholders to safeguard shareholders' wealth. Enron's fall, for example, has been widely seen in terms of the inability of its board to effectively monitor what its managers were doing, with conflict of interests identified as the root cause of the failure. Among the numerous criticisms leveled on Enron's fall was due to failure in its internal control system. A survey by KPMG Malaysia (2004) reveals a good internal control is rank as the first method to detect fraud. Companies may suffer total losses up to RM1 million owing to fraudulent conducts which can lead to being financially distressed. The findings of the survey suggest that the most common prevention method is to review and improve the internal controls.

Audit committee was first introduced in the United States (US) as an internal mechanism to mitigate corporate fraudulent practices. Audit committee in Malaysia started in August 1993 where the Malaysian Securities Commission gave notice to all companies listed on the Kuala Lumpur Stock Exchange to form audit committee. The companies were allowed to implement the requirement until 1994. However, in 1998 due to the Asian financial crisis, the Malaysian Institute of Corporate Governance (MICG) was established to pioneer the corporate governance domain in the country. The most important responsibilities were to produce a good practices guide for the companies in the same fashion as other advanced countries around the world.

2.10 Audit committee independence

According to the Malaysian Institute of Corporate Governance in their Best Practices of Corporate Governance, the board should establish an audit committee of at least three directors, a majority of whom are independent, with written terms of reference which deal clearly with its authority and duties. The Chairman of the audit committee should be an independent non-executive director.

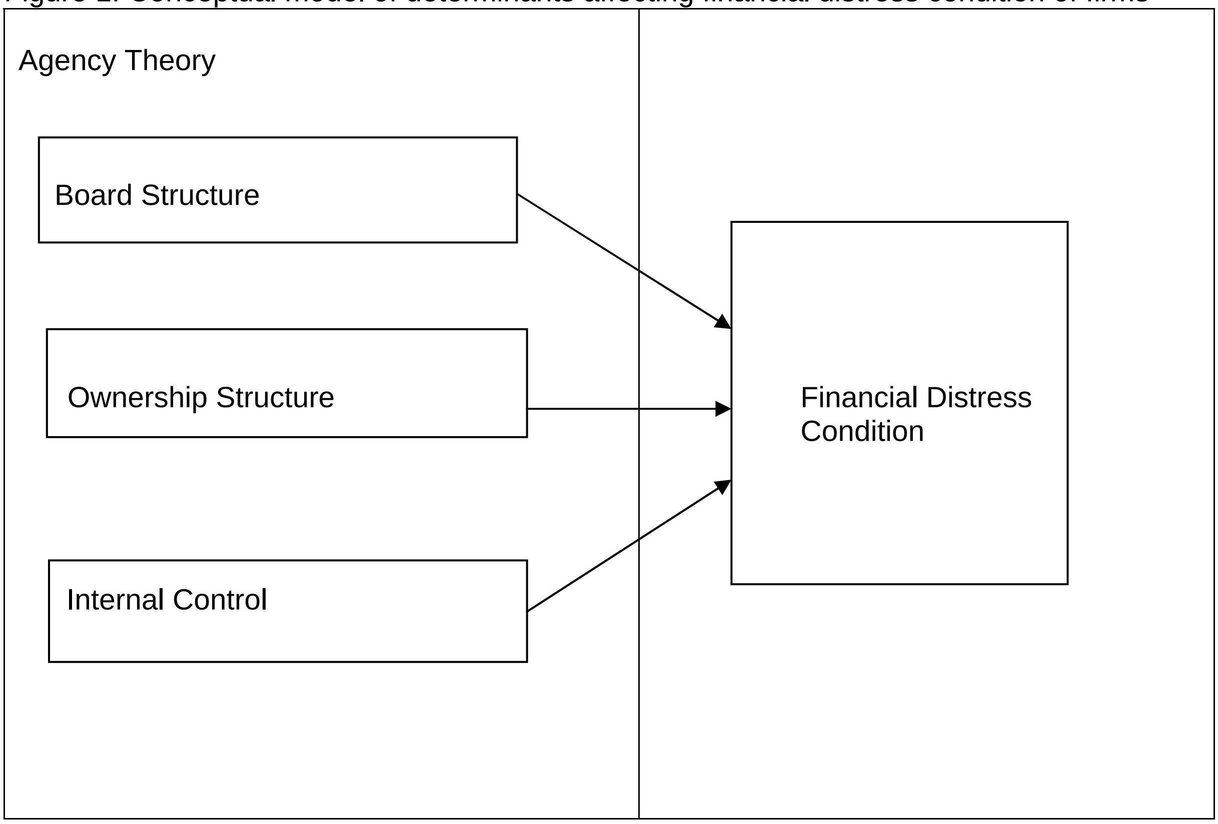
2.11 Audit committee expertise

The literature on audit committee composition involving member expertise suggests the importance of this area as a necessary component of audit committees effective functioning. Some of the studies also reported that many members are lack of adequate experience and expertise in relevant oversight areas. For example, DeZoort et al. (2001) find that audit committee members believe that all audit committee members should have sufficient expertise in oversight areas related to accounting, auditing and law. DeZoort et al.'s (2001) literature review on the effectiveness of audit committee suggested that it is critical to enhance the richness of measures of audit committee member independence, expertise, integrity and objectivity.

2.12 Theoretical framework

Drawing from the literature reviewed, the conceptual model for this study identifies three factors as primary influences on financial distress condition of a company, a) the structure of the board of directors of the company, b) the ownership structure of the company and c) the internal control system of the company.

Figure 1: Conceptual model of determinants affecting financial distress condition of firms

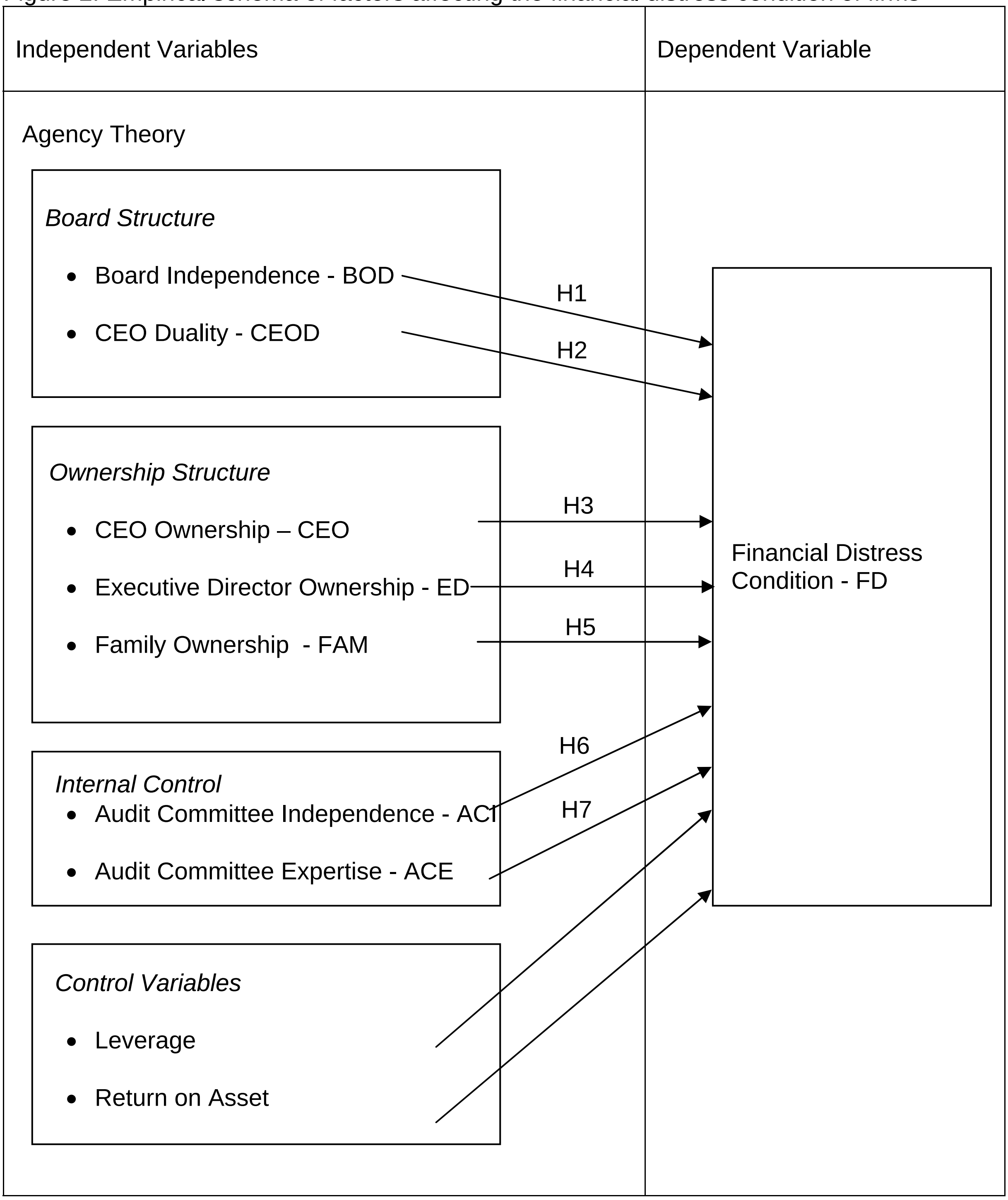


2.13 Empirical schema

The conceptual model is translated into the following empirical schema of the forces impacting financial distress conditions of firms. The dependent variable is the Financial

Distress Conditions (FD) of firms. Seven variables were identified to test the relationships between the dependent and independent variables. In addition to the identified independent variables, this study also includes leverage and return on assets. These variables is used to controls the financial risk and to control the differences in operating performance The inclusion of the control variables in the model was to avoid financial distress condition being influenced by other factors.

Figure 2: Empirical schema of factors affecting the financial distress condition of firms



Note: The relationships developed in the hypotheses can be depicted in an empirical schema as given in Figure 2.

2.14 Hypothesis

H1: The higher the proportion of independent directors on the board, the lower the probability for the company to become financially distress.
H2: CEO duality has a lower probability for the company to become financially distressed.
H3: The higher the percentage of CEO ownership the lower the probability for the company to become financially distressed.
H4: The higher the percentage of executive director ownership the lower the probability for the company to become financially distress.
H5: The higher the percentage of family ownership, the lower the probability for the company to become financially distressed.
H6: The higher the proportion of independent audit committee, the lower the probability for the company to become financially distressed.
H7: The presence of financial experts in audit committees results in a lower probability for the company to become financially distressed.

2.15 Model specification and analysis

The regression model used to test the hypotheses in the study is adopted from a study by Charitou et al (2007). The estimate logistic regression model is as follows:

FD = PCTBIND + DUALITY + PCTCEOWN + PCTEDOWN + PCTFOWN + PCTACIND + ACEXP + LEV + ROA (1)

Where,

FD is the financial distress conditions of firms
PCTBIND: proportion of independent directors in the board against total number of board of director.
DUALITY: to measure the whether the CEO and Chairman of board is the same person.
PCTCEOWN: percentage of common share held by CEO or Managing Director over total common share.
PCTEDOWN: percentage of common share held by executive directors over total common share.
PCTFOWN: percentage of common share held by family member that has a family relationship with director over total common share.
PCTACIND: Proportion of independent directors in audit committee over total member of audit committee.
ACEXP: Audit committee member that has financial expertise as regulated by Bursa Malaysia.

3. METHODOLOGY

In order to capture the data on the corporate governance and internal control factors that influence financially distress conditions of firms, the data from this study is collected from content analysis of companies' annual reports. The information was extracted from relevant sections of the annual reports, in particular from Corporate Information section, Statement of Corporate Governance, Director's Report and Analysis of Shareholdings. Data for audit committee independence and audit committee expertise are collected from Audit Committee Report. The companies' annual reports were downloaded from Bursa Malaysia website at **http://www.bursamalaysia.com.my.**This study is restricted to companies which are listed on Bursa Malaysia Stock Exchange. Companies listed on Bursa Malaysia represent large companies since the listing requirements for listing on Bursa Malaysia requires that for a company to be listed on the Main board and on Second board they need to have a minimum amount of paid up share capital of at least RM60 million and RM40 million comprising ordinary shares of RM1 each respectively. Large public companies are selected as corporate governance issues are usually more significant in large public companies.

Financially distressed companies are defined as those companies announced by Bursa Malaysia as PN 4 and PN17 companies. Companies fall under this category have fulfilled one of the criteria in Practice Note No.17/2005 in Bursa Malaysia. A three-year period of study was chosen from 1 January 2004 to 31 December 2006. The three-year window period enables an examination of the trends relating to conditions that contributed to firms being financially distressed. Firms belonging to the Banking and Finance industry and MESDAQ companies were excluded from the sample due to the specific nature of their business. A total of 97 companies were announced under PN17, amended PN17 and PN4 companies because of the fulfillment of at least one criteria which have been outlined in Practice Note No. 17 (PN17) and Practice Note No. 4 (PN4). There were a total of 97 companies announced as PN 17 and PN4 companies for the three-year period, 41 in year 2006, 36 in year 2005 and 20 in year 2004. However, nine companies were excluded since there were no match samples for non PN17 or PN4 companies for the three-year period. The remaining 88 companies were then matched with healthy ones (non PN17/PN4 companies for the same time period) based on their size and industries (Elloumi and Gueyie, 2001, Perry and Shivdavasani, (2005). Hence the final sample was 88 distressed companies and 88 non distress companies which make a total of 176 companies.

4. DATA ANALYSIS

4.1 Regression analysis

Regression analysis provides both the statistics for testing hypothesis as well as quantifying the impact of the independent variables on dependent variable. This study hypothesizes that company's distress condition to be associated with several factors in corporate governance such as board structure, ownership structure and internal control. The logistic regression analysis is used in order to preserve the matched character of the sample. Estimating the logistic regression model begins with selecting a method for specifying the regression model. Backward stepwise logistic regression model was used to analyze the data in this study. Six steps were generated using the backward stepwise method. Table 1 below shows variables removed in estimating the equation for the logistic regression model. The first variable removed was **PCTCEOWN** (percentage of CEO ownership), followed by **PCTFOWN** (percentage of family ownership), **PCTDOWN** (percentage of executive director ownership), **PCTACIND** (percentage of audit committee independence) and **ACEXP** (audit committee expertise).

Table 1: Variables removed in logistic regression model

Step	Variable	Coefficient	Std error	Wald Stat	Df	Sig.
1	PCTCEOWN	0.375	0.713	0.277	1	0.599
2	PCTFOWN	-0.493	0.744	0.438	1	0.508
3	PCTDOWN	0.290	0.490	0.349	1	0.554
4	PCTACIND	0.993	0.839	1.400	1	0.237
5	ACEXP	1.329	1.011	1.730	1	0.188

This study found only four out of the nine variables that was significantly associated with company's distress condition. Table 2 below summaries the results obtained from the logistic regression model.

Table 2: Result from logistic regression model

Variable	Coefficient	Std error	Wald Stat	Df	Sig.
PCTBIND	1.534	0.782	3.850	1	0.050
DUALITY	-1.903	0.811	5.507	1	0.019*
LEV	0.039	0.008	22.984	1	0.000**
ROA	-0.049	0.017	8.613	1	0.003**
Constant	-2.684	0.535	25.168	1	0.000

* * Significant at 1% level (1-tailed test).
* Significant at 5% level (1-tailed test).

The results indicate that there are four factors which have a significant impact on the company's financial distress condition. These are PCTBIND (percentage of board independence), DUALITY (CEO duality), LEV (leverage) and ROA (return on assets).The result suggest that companies' distress condition among listed companies in Malaysia is determined by the board structure via percentage of board independence, CEO duality, financial risk that is leverage and operating performance which is represented by return on assets.

4.2 Distress condition and board structure

Proxy variables that represent board structure used in this study were percentage of board independence (PCTBIND) and CEO duality (DUALITY). Both variables were significant at p value of 0.050 and 0.019 and beta coefficient of 1.534 and -1.903 respectively. However, the variable PCTBIND did not have the predicted sign. The adjusted p-value for 1-tailed test is therefore 0.975 (1 – ½ p) making it not significant. Thus, H1 which states that the lower the proportion of independent directors on the board, the higher the probability for the company to become financially distress is rejected. The result is not consistent with prior findings (Elloumie and Gueyie, 2005; Charitou et al, 2007; Chen et al, 2006 and Uzun, 2004) which argue that the lower proportion of independent directors on the board will increase the likelihood for the company to become financially distress. Petra (2005) also argues that outside directors on the board will increase the company's performance hence decrease the possibility of the company being financially distressed. The next variable in board structure is CEO duality gives a significant p value 0.019 and a negative sign of beta coefficient (-1.903) that indicates an inverse relationship between CEO duality and company's distress condition. Thus, H2 can be accepted. H2 hypothesized that CEO duality will reduce probability of the company to become financially distressed. This implies company's that facing financial difficulties has a different individual for CEO and the chairman of the board. Hence, the findings of this study provide contradict found by Abdullah (2006), Elloumie and Gueyie (2001) and Chaganti et al. (1985). Their study reveals that there is no association between CEO duality and distress condition. However, this finding is consistent with Simpson et al. (1999).

4.3 Distress condition and ownership structure

There are three variables under the ownership structure of the company; CEO ownership (PCTCEOWN), executives' director ownership (PCTDOWN) and executive director's family ownership (PCTFOWN). There are two proxy variables for management ownership, CEO ownership and executives' director ownership. It is hypothesized that higher management ownership will reduce the possibility for the company to become distressed. However these two variables were found to be insignificant with a p value 0.382, and 0.446 respectively. Therefore, the hypothesis is rejected. Findings of this study also provide conflicting findings with prior literature (Abdullah, 2004; Charitou et al. 2007, Kim et al. 2006 and Morck et al. 1988). Their studies revealed that higher management ownership will reduce the possibility for companies to become financially distressed. For family ownership, it is argued that higher proportion of family ownership will result in higher profitability and reduced the agency problem between agent and principle (Maury, 2005). However, this study revealed insignificant result with p value 0.992 which is not consistent with prior studies (Yammeesri and Lodh (2004; Silva and Majluf 2007).

4.4 Distress condition and internal control

There are two proxy variables used for internal control mechanism, independence of audit committee (PCTACIND) and audit committee expertise (ACEXP). Results of the study provide insignificant results with p value 0.237 and beta coefficient 0.993 for independence of audit committee and p value 0.188 and beta coefficient 1.329 for audit committee expertise. Therefore, H6 and H7 are rejected. The result did not support evidences found by Uzun (2004) and Abbott (2000) who found distressed companies have a lower independent audit member in their audit committee.

4.5 Distress condition and control variable

The control variables leverage (LEV) to control for financial risk and return on asset (ROA) to measure the operating performance are significant. Leverage has a p value 0.000 and beta coefficient 0.039. This suggests that distressed companies have higher leverage and are financially more risky. The findings are consistent with prior results by Samad et al. (2005) and Whitaker (1999) who have found company experiencing financial problem carried heavy debt burden. The return on asset is also significant with a p value 0.003 and beta coefficient -0.049. Results indicate an inverse relationship between return on asset and financial distressed condition, implying that distressed condition companies have a lower return on asset. This suggests that distressed companies are not performing in their business operations. Findings are consistent with that of Sawandi et al. (2005) and Che Haat et al. (2005) who have studied PN4 companies in Malaysia and found that such companies have serious profitability problem leading them to become financially distressed.

5. CONCLUSION

The results of the study show that CEO duality has a negative impact on corporate failure. The findings reveal that CEO duality has significant influence in reducing the probability of companies becoming financially distress. The results implied that when the chairman of the board is also the CEO, it will help in decision making as he can concentrate on company's goals and objectives. Thus, a quick implementation of organization's operational decisions can be made. A powerful CEO-Chairman can make good decisions resulting in good performance for the company as he can perform effective business operation plans in order to avoid the company from suffering financial problems. CEO duality will reduce agency problem as the agent will act in his best interest since he can provide better strategic vision in company's goals and objectives. The findings reveal no significant association between independent director and company distress condition. Thus, the independence of directors may not be enough to act as an effective monitoring mechanism in order to avoid companies from becoming financially distressed. The percentage of independent directors as required by the MCCG may not be sufficient to curb agency problem. Also, the independent directors may lack the required competency as well as information to effectively and efficiently perform their roles. The results also indicate that the ownership of the companies by CEOs, executive directors and their family members do not have an impact on company's distress condition. The results imply that ownership may not be able to serve as a mechanism for resolving the conflict of interest among the agents and the principal. Hence, we can conclude that internal ownership i.e. CEOs, executive directors and their family members have failed in their role as monitoring agents. The function of the audit committee in terms of being independent and as the expert showed no impact on company's financial condition. The suggestion of importance of audit committee independence and audit committee accounting knowledge as a necessary component of audit committee may become insignificant since they may not be effective in monitoring the company's operation. There are a number of possible reasons for this. First, the audit committee independence is seen as being ineffective in discharging their duties due to management dominance over board matters. Secondly, audit committee may lack the knowledge and qualification required to monitor and assess the conduct and quality of financial statements. Thus, it may not be sufficient to promote effective control mechanism between the agent and the principal in a company.

Another possible reason for some of the corporate governance variables not being associated with company's financial condition is the suitability of the monitoring mechanisms recommended by MCCG (2000) to be adopted within the Malaysian environment. Since the MCCG (2000) is adopting some principles recommended by the Cadbury Report (1995) and Hampel Report (1998), the term "one size fits all" may not be applied to Malaysian companies which are different from UK companies especially in terms of economic development between the countries as well as their business and political culture. The study also discloses evidence on company's financial and operating performance where it is statistically proven that leverage has a strong positive relationship and return on asset has a negative relationship with company's distressed condition. The two control variables; leverage and return on asset showed significant relationships with financial distress condition.

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Appendix

Table 1: The measurement for the dependent, independent and control variables and their predicted sign

Variables	Measurement	Symbol	Predicted Sign
Financial distress	Dummy of 1 for PN17 companies and 0 for healthy company Charitou et al (2007), Elloumi and Gueyie (2001) and Abdullah (2004).		
Board independence (%)	The proportion of the number of independent directors against the total number of directors on the board. A binary or dummy variable of 1 will be assigned if the proportion is less than 33% and 0 if it is otherwise.	PCTBIND	-
CEO duality	A dummy variable of 1 is assigned if the CEO also carries out duties as the Chairman of the Board and 0 if otherwise. (Charitou et al 2007, Elloumi and Gueyie 2001 and Abdullah 2004).	DUAL	-
CEO ownership	The percentage of common shares held by the CEO or the Managing Director is proportioned over the total number of common shares issued. For a holding of less than 5% a dummy variable of 1 is assigned while it is 0 if the CEO holds 5% and above of the common shares.	CEOWN	-
Executive Director Ownership	The proportion of the common shares held by all executive directors is measured over the total number of common shares issued. A dummy variable of 1 is assigned if the percentage of common shares held is less than 5% and 0 if it is otherwise.	EDOWN	-
Family Ownership	The proportion of common shares held by family member that has a relationship with director in the	FOWN	-

	board over total common shares issued. A shareholding of less than 10% is stated as 1 while 0 if it is otherwise (Yammeesri and Lodh 2004, Maury 2006),		
Audit Committee Independent	The number of independent directors in the audit committee over the total number of the audit committee members. If the percentage is less than 50% then a dummy variable of 1 is assigned while if is 50% or more the variable 0 is assigned instead.	ACIND	-
Audit committee expertise	A dummy variable of 1 if there is no financial expert sitting on the company's Audit Committee and a 0 if it is otherwise	ACEXP	-
Leverage	Percentage of total liability over total asset.	LEV	+
Return on asset	Earning before tax divided by total asset.	ROA	-