UNIVERSITI TEKNOLOGI MARA

THE EFFECT OF CORPORATE GOVERNANCE ON TRANSPARENCY AND PERFORMANCE OF MALAYSIAN COMPANIES

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ABSTRACT

Ideally, high corporate governance standards have been linked to higher firm performance. An effective governance framework should strike a balance between conformance and performance. Hence, the current study attempts to examine the adequacy of reporting and corporate governance practices by using corporate governance reporting score. In addition, it also attempts to find out whether good corporate governance practices have a positive relationship with corporate transparency and performance.

Apart from developing a Malaysian-based corporate governance reporting score, this study attempts to compare corporate governance practices in companies with good financial performance and those with relatively SV-destroying. The sample consists of 145 companies, 73 companies selected by KPMG/*The Edge* Award (Lee, 2003), which are considered to have SV-enhancing in terms of shareholder value creation and used as a benchmark to evaluate the rest of companies listed on Bursa Malaysia. The other group consists of 73 non-award achievers which represent SV-destroying companies. Studying corporate governance practices of these two groups of companies would help understand the importance of this issue in improving timeliness of reporting and the extent of disclosures, which in turn should positively affect a company's market performance. This should be the case for comparable companies that have improved business performances.

The results of the survey reveal that there is much room for improvement vis-à-vis Malaysian companies reporting of their practices, as the Mean CG reporting score of these sample firms only came up to 51.3 percent. Comparing between good and SV-destroying companies, in general SV-enhancing companies disclose more but the difference is very marginal and statistically insignificant. Furthermore, the overall findings reveal that CG reporting has been found lacking mainly in areas such as Strategic Planning and Performance Management, Risk Management and Internal Control, Accountability and Transparency, Business Ethics and Responsibility, and Intellectual Capital.

It was found that corporate governance factors have a strong predicting power on company performance, mainly due to debt monitoring and foreign ownership. However, there is a significant negative relation between audit quality and performance. When testing the hypotheses whether the high performance is due to better disclosure and timely reporting, the results found that performance is not associated with the level of disclosure and timely reporting. The results indicate that disclosure and timeliness are not significant contributing factors in the relationship between corporate governance and market performance and therefore the findings do not support signalling theory. In general, the findings raise the issue of ineffectiveness of monitoring power by Malaysian corporate governance standards to directors and insiders as well as the usefulness of financial report itself.

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CHAPTER 1

INTRODUCTION

This chapter provides the background and motivation for the study. It also presents the objectives of the study in section 1.3, followed by the significance or contribution of this study in section 1.4. This chapter ends with section 1.5 which outlines the contents of this thesis.

1.1 INTRODUCTION

The Asian financial crisis that started in 1997, partly originated from the prolonged recession in Japan in the early 1990s (Sachs, 1998), adversely affected the performance of many East Asian economies. Malaysia was not spared from the contagion effect that followed throughout 1998. It is generally believed that a lack of sound corporate governance was to a certain extent, a major reason for this economic crisis in the East Asian region (e.g., Kim, 1998; D'Cruz, 1999; Khas, 2002).

Apart from that, the tragic downfall of worldwide corporate giants which came later than the Asian financial crises such as Enron, (the world's biggest energy-trading company which collapsed in December 2000), Xerox, Worldcom and Parmalat (to name a few) have left deep implications on the corporate world in general. It has been shown that most corporate failures including Enron and Worldcom, can be caused by the lack of good corporate governance. The US accounting scandals hastened the understanding of the wide-ranging effect poor corporate governance can have on a country's economy through their effects on the capital markets. Such an incident had adversely affected public confidence in the reliability of corporate reporting.

In Malaysia, the 1997-98 financial crises as well as the scandals in the US have been considered as a wake-up call to the need for better corporate governance and