

**UNIVERSITI TEKNOLOGI MARA**

**THE EFFECTS OF CORPORATE  
GOVERNANCE ON PERFORMANCE  
OF FEDERAL STATUTORY BODIES  
IN MALAYSIA**

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## ABSTRACT

Malaysia is enthusiastically implementing the Government Transformation Program (GTP) to become a high-income developed nation by year 2020. Its government has assured citizens that it would embody the highest standard of ethical conduct and good governance in order to accelerate the performance of public sector agencies. In spite of this assurance, Malaysia is still facing shortcomings as far as governance is concerned. Prominent personalities have indicated that “Malaysia’s lack of knowledge in governance was the root problem.” And “It is lacking in term of creating a culture of corporate governance within an organisation.” In addition, International bodies such as Transparency International and Asian Corporate Governance Association have proposed for Malaysia to strengthen its public governance and corporate governance culture. This study investigates the effects of corporate governance (CG) on performance of Federal Statutory Bodies (FSB). It also examines the level of knowledge of CG, level of CG practices among board of directors (BOD) and executive management (EM) and gauges whether CG has become a culture in FSB. This study adopts 5 theories: agency theory; stakeholder theory; stewardship theory; institutional theory and resource dependency theory that underpin the relationship between CG and FSB performance. A mixed quantitative methods: content analysis and questionnaire survey were employed. For content analysis, pooled OLS and generalised least squares (GLS) have been tested to analyse panel data over 5 year period from 2009 to 2013 for 51 FSB. The study found a strong evidence of significant positive effects of CG, including internal and external governance mechanisms on FSB performance represented by Return on Equity; Return on Assets; Key Result Areas; and Accountability Index. It was also found that this study supported all the 5 theories that formed the theoretical rational for the effects of CG on FSB performance. The four internal CG mechanisms: board size; board independence; board diversity and CG disclosure have assisted in overcoming the agency problem, acted as effective resources providers, stewards and stakeholders that improved performance of FSB. The four external CG mechanisms: employee power; leverage power; regulatory authority and professionalisation have also supported the stakeholder and institutional theories. The findings of questionnaire survey on the level of knowledge of CG among BOD and EM reveals the need to update and improve their knowledge of CG. In addition, the perception of BOD and EM and their actual practice of CG in FSB implies that they need to internalise CG as a culture, a way of life. This study indicates that only about half of FSB have embraced CG as their culture and about half of BOD and EM in FSB require a code on corporate governance in public sector in order to enhance their performance. Bearing in mind the findings of this study, current shortcomings and responding to international agencies’ calling, there is an urgent need for public sector governance reform that aims to strengthen public sector governance culture. With the strong commitment of the new government, implementation and review of effective CG practices over time will lead to internalisation of CG culture, enhancing service deliveries, performance and realisation of Vision 2020.

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

For decades, businesses have been crucial in developing the modern world and lifting billions of people out of poverty. However, the business world also has an unfortunate habit of taking it too far and embarking in unethical practices and behaviour. This has led to the corporate scandals and collapses in 1980s and the financial crisis in the 1990s and 2000s which have prompted all parties to re-evaluate their corporate governance practices.

In the wake of a spate of corporate scandals in 1980s, the London Stock Exchange, The Financial Reporting Council and the accounting profession published their committee report, "*the Financial Aspects of Corporate Governance*" on 1 December 1992. The report became known by the name of its chairman, Sir Adrian Cadbury, as the "*Cadbury Report*". It contains the code of best practice which focuses on function of directors, auditor and accountabilities. The Cadbury report began as a modest exercise in response to several high profile cases of corporate fraud and director malfeasance. It has also laid the groundwork for the development of international standards of corporate governance which became the benchmark for national and even firm level initiatives (Jordan, 2012).

The 1990s have been the decade of corporate governance. The momentum was observed in the U.K. with a 1995 report on executive pay by a blue-ribbon committee chaired by Sir Richard Greenbury (Greenbury, 1995) and a 1998 report by a committee chaired by Sir Ronald Hampel that reviewed the work done by the Cadbury and Greenbury committees (Committee on Corporate Governance, 1998). The Cadbury Code would soon serve as a model for the development of CG codes in various countries around the world (Cheffins, 2000: 12-13). As the Hampel Report (1998) said, Cadbury had "*struck a chord in many overseas countries; it has provided a yardstick against which standards of corporate governance in other markets are being measured.*" (Committee on Corporate Governance, 1998: paragraph 1.5).

The Asian stock market crash in 1997-1998 was cited to be caused by the weaknesses in corporate governance. It has prompted legal reforms and development