THE IMPACT OF BOARD STRUCTURE ON THE PERFORMANCE OF ACQUIRING FIRMS

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ABSTRACT

Agency problem arises within a firm whenever board of directors as agents have incentives to pursue their own interests at shareholders' expense. The shareholders need to govern and monitor their corporate managers and directors in order to keep their objectives aligned. The concept of corporate governance provides response to this agency problem and the related bodies have outlined various governance mechanisms as guidelines for the shareholders in monitoring and controlling their professional directors. However, it is important to know whether the best practices suggested in the corporate governance guidelines and from the agency theory itself resulted in the directors making strategic decisions in the best interest of the shareholders.

Therefore, the current study examines the association between board structure and the operating performance of Malaysian acquiring firms for the period 1996 – 1998. Four elements of board structure are examined: board size, dual leadership, CEO ownership and involvement of outside directors. Based on a sample of 85 acquiring firms, the study finds that there is no significant relationship between board structure and operating performance of Malaysian acquiring firms for the periods 1996 – 1998. The current study also finds that there is a significant underperformance of Malaysian acquiring firms in the post acquisition operating cash flow performance when compared to the prior periods. These findings suggest that board structure has no significant impact on the decision made by the board of directors, and thus on the operating performance of the firms.

Chapter I

INTRODUCTION

1.0 Introduction

Agency problem arise within a firm whenever board of directors as agents have incentives to pursue their own interests at shareholders' expense. The emergence of the concept of corporate governance provides response to this agency problem. The related parties involved in the setting of regulations for corporate governance outline various governance mechanisms or best practices which can serve as guidelines for the shareholders or owners of the firm in monitoring and controlling their directors and managers. Particularly in Malaysia, all public listed companies are urged to adhere and follow the suggested governance best practices in terms of the effective board structure and independence which includes the involvement of outside directors on the board, CEO ownership, board size and dual leadership.

In recent years, considerable research in the U.S. has focused on the composition of the board of directors and the importance of outside directors (e.g. Hayward and Hambrick, 1997; Dalton and Daily, 1998; Rhoades et. al., 2000; Bhagat and Black, 1997 and Subrahmanyam et. al., 1997). The findings suggest that outside directors play an important monitoring role in the governance process, particularly in large transactions such as acquisitions, which can involve agency problems between inside managers and shareholders.