

Board Characteristics, Firms' Specific Factors and Financial Performance: Evidences from ACE Market in Bursa Malaysia

Mohamad Azwan Md Isa¹, Nor Hazila Ismail², Maizura Mohd Isa³

1 Faculty of Business Management, UiTM Johor Branch, Segamat Campus, Johor Malaysia and moham821@uitm.edu.my

2 Faculty of Business Management, UiTM Johor Branch, Segamat Campus, Johor Malaysia and norha884@uitm.edu.my

3 Faculty of Business Management, UiTM Johor Branch, Segamat Campus, Johor Malaysia and maizu493@uitm.edu.my

Abstract

Financial performance is of great importance that must be looked into particularly by a firm's management, shareholders and lenders when analysing success or failure of the firm. It is also one of the crucial criteria, which must be examined by potential investors, government regulatory bodies and other stakeholders before deciding to make any decisions about the firm. Hence, this study aims to investigate the relationships and impacts of five (5) firms' specific factors, namely diversified board members' gender, board's independence, the firm's growth, leverage and market capitalization on firms' financial performance, which is measured by return on asset (ROA) and Tobin-Q. This study applies the methods of descriptive statistics, Pearson correlation and multiple regressions to test and analyse the selected variables. Using 210 firm-year panel data or observations for periods from year 2012 to 2017 of 35 firms listed in ACE Market of Bursa Malaysia, we have found that leverage and market capitalization are the two key factors that pose negative and positive significant influences on firms' financial performance, respectively. These findings suggest that firms must strictly observe the optimal debt or leverage level as this will affect firms' financial performance that eventually has impacts on firms' value and shareholders' wealth.

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INTRODUCTION

Financial performance is an important criterion used to measure the current condition of a firm. Firms stress heavily on achieving their targeted financial performance as this portrays their efficiency in managing the resources, ability to generate profit or return and capability to survive in the market against their competitors. Financial performance also tells us how healthy firms are financially, specifically in term of cash flow. Investors, creditors and suppliers, for instances, will look at the firm's financial performance before they decide to perform any transactions with the firm. Sound and positive financial performance will surely strengthen the investors and creditors' confidence in the firm's business and operation. Basically, there are many factors that affect firms' financial performance. The factors could be either externally such as economic development and growth and political stability (Hosny, 2017) or internally like firm's liquidity (Omondi & Muturi, 2013)

as well as firm management's efficiency, effectiveness and competency (Skandalis, Liargovas & Merika, 2008). Due to uncertainty and inconsistency in these factors, firms' financial performance fluctuates from year to year. Firms tend to put extra focuses on managing and monitoring their growth, leverage and equity since these elements traditionally seem having great impacts on their financial performance. They neglect other factors that could render significant effects to the firms' financial performance such as board characteristics. Firms assume that board characteristics are not that important and having little impact on firms' financial performance (Liu, Miletkov, Wei, & Yang, 2015).

The impacts of board characteristics on financial performance have gained increased attention by researchers for the last two decades particularly in the wake of corporate scandals and failures (Bathula, 2008). Board characteristic or value plays utmost roles in firms because it is directly connected to corporate governance

practice. Due to its crucial factor, Securities Commission Malaysia (SC) had introduced Malaysian Code on Corporate Governance (MCCG) in the year 2000. Malaysian public listed firms are required to comply with MCCG rules and regulations (Bhatt, 2016) and the firms must report their corporate governance practice in the firms' annual report. In the aftermath of the 1997/1998 Asian financial crisis, there witnessed the vulnerability of firms and deterioration in the firms' corporate performance (Claessens, Djankov & Xu, 2000). One of the main reasons was that the firms did not take the functions of corporate governance seriously particularly in monitoring firms' financial performance. Hence, this study will look into the board-related factors along with other firms' specific factors, namely firms' growth, leverage and market capitalization and the impacts on firms' financial performance.

ACE Market

ACE Market is one of the markets at Malaysian Stock Exchange, namely Bursa Malaysia. ACE stands for 'Access, Certainty, Efficiency' that previously was known as the Malaysian Exchange of Securities Dealings and Automated Quotation (MESDAQ), which was established in 1997. It is a specific market for the newly start-up firms and mainly consists of the technology-based firms' stocks that have fast and high growth in the industry (Ping, 2010). The number of companies listed in the ACE market keeps on fluctuating and one of the main reasons behind the listing and delisting is attributable to inconsistent financial performance.

This current study has its major contribution as it sheds light on ACE firms' financial performance with regards to the firms' board characteristics besides the firms' specific factors. This paper is in contrast to Ghasemi and Razak (2017), who studied the impacts of firms' specific factors on the profitability (ROA and ROE as proxies) of ACE market. Thus, this study aims to investigate whether board members' gender, board independence, firms' growth, level of leverage and market capitalization have any significant impact on the firms' financial performance of 35 companies listed in ACE market at Bursa Malaysia.

The rest of this study will be arranged as follows; review of literature, data and methodology, results analysis and discussion and ends with conclusion and recommendation.

2.0 REVIEW OF LITERATURE

There are many proxies used to measure firm financial performance. Among the most common proxies

are return on investment (ROI), return on asset (ROA), return on equity (ROE) and Tobin-Q and the results shown by previous studies are mixed. In this study, we use ROA to measure financial performance as studied by Core, Holthausen, and Larcker (1999). In addition to ROA, we also test financial performance by Tobin-Q as used by Adams and Ferreira (2009), who claimed that the Tobin-Q could generate a more accurate result for firm financial performance. Their finding is consistent with Wernerfelt and Montgomery (1988), who also proved that there is a positive significant result using the Tobin-Q for financial performance. On the contrary, Fuzi, Halim, and Julizaerma (2016), and Haniffa & Hudaib (2006) concluded that there is no significant impact of using Tobin-Q.

Board characteristic constitutes the board members' gender, the size of board and status of the board, whether they are independent or non-independent. The board of directors (BOD) comprises persons, who are responsible to set up the strategy, policy and planning to ensure survival of firm (Brancato, Tonello, Hexter, & Newman, 2006). BOD is appointed and empowered by shareholders to run the firm, so they are supposed to have certain knowledge, experiences, expertise and competency to solve firms' problems and monitor the management activity in order to act in the best interest of shareholders (Rose, 2005). The BOD is also responsible to select and appoint the firm's top management and monitoring all the management strategies (Fama & Jensen, 1983). According to Adam and Ferreira (2009), female board members are stricter, disciplined and risk-averse in monitoring firms' activity. Huse & Nielsen (2010) suggest that diversified gender among board members is beneficial and more effective for firm strategic control. This finding is supported by Levi, Li, and Zhang (2014). However, Sila, Gonzalez, and Hagedorff (2016), Pelled, Eisenhardt, and Xin (1999) dispute these findings. Other studies by Dwyer, Richard, & Chadwick (2003), Kagzi and Guha (2018), Strøm, D'Espallier, and Mersland (2014) and Conyon and He (2017) reveal a positive relationship between diversified board member gender with firm financial performance.

The existence of board independence could help improve firms' financial performance and efficiency due to independent critics and advice from the board (Uribe-Bohorquez, Martínez-Ferrero, & García-Sánchez, 2018). An independent board could provide the best analysis towards the firms and management behaviour (Ibrahim & Angelidis, 1995). On top of that, the independent board will ensure a balance of power and prevent abuse of power by the insiders or internal management of a firm. Meanwhile, Park and Shin (2004) and Fuzi et al. (2016)

conclude a positive relationship between board independence and a firm's financial performance.

Firm growth can be measured using the changes in firms' historical sales. In order to ensure continuous growth, a firm's management must be equipped with necessary knowledge and experience. This would help the firm to meet the customers' expectation that could lead to increase in demand from customers. Firms need knowledge to expand their businesses because through knowledge, the firm's management come up with the strategies towards firm growth. Audretsch, Houweling, and Thurik (2004) argued that knowledge and individual behaviour cannot influence firm growth. Continued firm growth will attract more capital from investors because of larger confidence. Increased growth also would reduce a firm's dependence on leverage besides gaining customers' satisfaction and employees' loyalty. Rashid (2018) stated that firms will be able to have continually better financial performance when they have positive growths. This finding is consistent with Murphy (1985), who found a positive relationship between firm financial performance and growth.

Leverage is another critical element that is closely related to firm financial performance. Higher leverage represents higher dependency of a firm on debt to finance the firm's business and activity. The main reason firms employ large debt is because of its lower after-tax cost of capital as compared to a higher cost of capital for equity or shares. Leverage is also able to save firms in the form of tax shield or tax relaxation (Hutten, 2014). Optimal level of leverage used by firms is not only improving the firm's value but also minimising the firm's overall cost of capital. Taking leverage into the capital structure could give lots of benefits to firms. However, more leverage or debt in the firm comes together with other costs, such as increase in credit or financial risk and requirement for higher return on equity (ROE) by shareholders to compensate for the increased risk. This, in the end, will reduce the profit retained by firms for reinvestment or future expansion. Weill (2003) concluded that there is a negative relationship between the level of leverage and firm financial performance.

Market capitalization is a proxy to measure the firm size. Larger market capitalization reflects a larger firm size that indicates a higher potential of survival of firms against the competitors. The larger market capitalization also shows higher confidence of investors on the firms' financial performance. The large market capitalized firms have better opportunity for business expansion due to easiness to raise a larger fund through the market. Even though large size firms are not

depending on loan or debt, the firms could easily obtain the loan or debt if they want to. This is because the lenders or creditors have enough confidence on their repayment capability in the future. These facts are supported by Majumdar & Chhibber (1999), who claimed that the large-size firms have a lot of capabilities in managing their activities particularly in financing and investing. Larger market-capitalized firms are expected to consistently maintain their financial performance because of highly capable management teams running the firms. According to Booth & Deli (1996), the large size firms usually have wide or broad external contacts that could help them build a strong network besides supporting them to survive in the market or industry. Large size firms could easily obtain the market or industry information from their subsidiaries to make any well-informed decisions in the future. Overall, it shows that there is a positive relationship between market capitalization and a firm's financial performance.

Based on the previous studies and review of literature, we develop the following hypotheses for this study:

Hypothesis 1: *A positive relationship between diversified board member's gender with firm's financial performance.*

Hypothesis 2: *A positive relationship between board independence with firm's financial performance.*

Hypothesis 3: *A positive relationship between firm growth with firm's financial performance.*

Hypothesis 4: *A negative relationship between firm leverage with firm's financial performance.*

Hypothesis 5: *A positive relationship between firm market capitalization with firm's financial performance.*

3.0 DATA AND METHODOLOGY

This current study uses 210 firm-year panel data or observations of 35 newly start-up firms listed in ACE Market at Bursa Malaysia. The data covers six (6) years on an annual basis from the year 2012 to 2017, which is obtained from the Thompson Reuters DataStream. The data is run using the EViews 10 software and employing the methods of descriptive statistics analysis, Pearson correlation analysis and multiple linear regression analysis.

The dependent variables consist of return on asset (ROA=net income/total asset) and Tobin-Q (TQ=total market value/total asset) whilst independent variables comprise board gender (BG;1=diversified, 0=not diversified), board independence (BI=number of

independent board members), firm's growth ($GROWTH = \frac{sales_1 - sales_0}{sales_0}$), leverage ($LEV = \frac{total\ debt}{total\ asset}$) and market capitalization ($MCAP = share\ current\ market\ price \times total\ number\ of\ shares\ outstanding$).

4.0 RESULTS AND DISCUSSION

4.1. Descriptive Statistics Analysis

Table 1 Descriptive Statistics

	ROA	TQ	BG	BI
Mean	-0.08	0.00	0.32	49.02
Median	-0.03	0.00	0.00	50.00
Max.	1.19	0.01	1.00	83.33
Min.	-3.01	0.00	0.00	25.00
SD	0.32	0.00	0.47	12.95
Skewness	-4.59	3.04	0.78	0.32
Kurtosis	40.61	15.17	1.60	2.42
Prob.	0.0000	0.0000	0.0000	0.0392

	GROWTH	LEV	MCAP
Mean	-0.02	0.14	70169.45
Median	-0.19	0.07	46884.00
Max.	224.96	4.19	503834.00
Min.	-68.14	0.00	8097.00
SD	17.72	0.36	79283.99
Skewness	9.21	9.09	3.08
Kurtosis	127.18	94.43	14.13
Prob.	0.0000	0.0000	0.0000

ROA shows a negative mean value, -0.0819 whereas TQ indicates positive mean, 0.0015. This is possible as ROA is calculated using firms' net income or loss whilst TQ is derived from the market value of firms using share market price times the total number of shares outstanding. ROA indicates larger dispersion from its means, where its standard deviation stands at 0.3190 compared to TQ that has very low dispersion from its mean at 0.0014. Looking at the skewness results, ROA shows wider skewness at 4.5902 to the left whereas TQ skewness stands at 3.0443 to the right. So are the kurtosis results, which tell us that data for ROA is largely not symmetrical around its mean compared to TQ. Based on probability values, it is known that the data for both ROA and TQ do not perfectly match the normal distribution.

The four independent variables show positive mean values except for the firm GROWTH. This implies negative growth, where firms experienced decline in sales year after year. MCAP has the highest mean, followed by board independence (BI). Even though

GROWTH records the second highest value, increase by 225%, it also reports the lowest value, namely decline by 68%. MCAP, GROWTH and BI note the three largest dispersions from their means, respectively based on the standard deviation. GROWTH, LEV and MCAP are quite largely skewed to the right and the data series of three variables are not normally distributed as shown by kurtosis and p-values results.

4.2. Pearson Correlation Analysis

Based on the results, the largest correlation is recorded between ROA and leverage, where the coefficient is -0.4048. This indicates a medium correlation between two variables and both move in an opposite direction. This finding answers the hypothesis 4, where leverage and ROA have a negative relationship. However, leverage shows a positive correlation with TQ. This is consistent with previous studies that reported mixed results (Hutten, 2014) and (Weill, 2003). Market capitalization is the second largest variable that shows correlations with ROA and TQ, but both in a positive direction.

Board gender, board independence and firm growth indicate a very weak correlation with ROA and TQ, respectively. Board gender shows a negative correlation with ROA and TQ. This signifies that the more diversified board members' gender, the lower financial performance of firm will be, and vice versa. This finding is consistent with Sila et al., (2016) and Pelled et al., (1999). Meanwhile, board independence and firms' growth show mixed correlations with ROA and TQ, respectively. This means that board independence and firm growth at times could move in the same direction with firms' financial performance and at times, the other way around. This is not surprising as the firms listed in the Ace Market are the newly start-up and growing firms, where they could have positive growths in sales but negative income (net loss) that are most probably due to large capital expenditure and financing cost. Whereas, among five independent variables, there are weak correlations (≤ 0.2). It is comfortable to say that there is no multi-collinearity problem among the independent variables.

4.3. Multiple Linear Regressions Analysis

Table 2 Multiple Linear Regressions (ROA as DV)

Variable	Coeff.	SE	t-Stat.	Prob.
C	0.0752	0.0901	0.8346	0.4049
BG	-0.0089	0.0461	-0.1934	0.8469
BI	-0.0029	0.0016	-1.7726	0.0778
GROWTH	0.0004	0.0011	0.3437	0.7314
LEV	-0.3616	0.0569	-6.3509	0.0000
MCAP	0.0000	0.0000	2.0135	0.0454

F-stat.	9.8363
Prob. (F-stat.)	0.0000

Table 3 Multiple Linear Regressions (TQ as DV)

Variable	Coeff.	SE	t-Stat.	Prob.
C	0.0006	0.0004	1.4135	0.1590
BG	-0.0003	0.0002	-1.5029	0.1344
BI	0.0000	0.0000	1.4808	0.1402
GROWTH	0.0000	0.0000	-0.7123	0.4771
LEV	0.0011	0.0003	4.2692	0.0000
MCAP	0.0000	0.0000	3.3872	0.0008
F-stat.	6.7499			
Prob. (F-stat.)	0.0000			

Based on the Panel Least Square method of the multiple linear regression's results, we have developed the following two models:

Model 1: $ROA = 0.075185 - 0.00891BG_{it} - 0.00287BI_{it} + 0.000392GROWTH_{it} - 0.36163LEV_{it} + 0.000000515MCAP_{it} + \varepsilon$

Model 2: $TQ = 0.000593 - 0.00032BG_{it} + 0.0000112BI_{it} - 0.00000378GROWTH_{it} + 0.001132LEV_{it} + 0.00000000403MCAP_{it} + \varepsilon$

4.3.1. F-test

Probability value of F-test suggests that both models are fit or all the variables fit in the models. The p-values are less than 0.05, namely at 5% level of significance. The p-value is 0.000000 when we tested using ROA as the proxy for firm's financial performance whilst the p-value is 0.000008 when we tested using TQ as the proxy for firm's financial performance.

4.3.2. T-test

The T-test results show that only leverage and market capitalization pose significant influences on the firms' financial performance. The p-value of each variable is less than 0.05 when tested with ROA and TQ, respectively. The results also indicate that market capitalization has positive influence on the firms' financial performance, either tested ROA or TQ as a proxy for financial performance. The finding confirms our hypothesis 5 and supports previous study by Majumdar and Chhibber (1999). This finding indirectly suggests that large size or market-capitalized firms would have better financial performance. This is of course closely related to market or investors' confidence, which have increased their investment in the firms and boosted the firms' share market price. However, leverage causes mixed effects on the firms' financial performance. It has

a negative impact when tested on ROA and this finding supports Ghasemi and Razak (2017), whereas it poses a positive impact when tested on TQ. The reasons might be because different numerators were used to calculate ROA and TQ. The larger leverage or debt employed by firms, the larger financing cost or interest expense firms need to pay. This will reduce the net income and ROA and this finding is consistent with Weill (2003). Meanwhile, TQ is related to firms' value. The larger leverage used will enable firms to improve the firms' value and income due to a larger tax shield or saving contributed by the leverage and this finding is consistent with Hutten (2014).

Diversified board gender is not found to have significant influence on the firms' financial performance based on the p-value more than 0.05. Apparently, for ACE market listed firms, it does not matter whether the board members' gender is diversified or not because there is no significant influence on the firms' financial performance. Nevertheless, diversified board gender negatively influences the firms' financial performance. This means that the more the numbers of female members on the board, it will cause the firms' financial performance to fall. This finding might be unique to Malaysian firms especially for new and growing firms. The reason might be because female board members are more risk averse and less aggressive in making investment and other business decisions. This will hinder the firms from achieving high revenues and income. The negative influence of diversified board gender on financial performance had been disclosed by Sila et al., (2016) and Pelled et al., (1999).

Board independence and firms' growth are also found not to be significant in influencing firms' financial performance. However, both variables' impact on firms' financial performance are mixed. Previous studies found positive impact by board independence on financial performance, and this is true as revealed by model 2, where TQ as a proxy for financial performance. The positive impact of board independence on the firm's financial performance supports the findings by Park and Shin (2004) and Fuzi et al. (2016). In contrast, ROA is found to be negatively influenced by board independence. We are of the opinion that, as newly start-up firms, the management of firms will be very prudent in taking any business decisions, especially if there are independent board members, who will freely criticise and closely monitor the management's activities. This will have directly affected the sales and profit performance of firms. Whereas, firm's growth positively affects the ROA and this is consistent with Rashid (2018) and Murphy (1985). Meanwhile, firm's growth negatively affects the TQ and this is consistent with Ghasemi and Razak (2017).

5.0 CONCLUSION AND RECOMMENDATION

This paper investigates the relationship between board characteristics and firms' specific factors with firms' financial performance of 35 listed firms in ACE Market, Bursa Malaysia. The F-test statistics show that the two models are fit, tested either using ROA or TQ as proxy for firms' financial performance. Meanwhile, the T-test statistics reveal that only the leverage and firms' market capitalization have significant influences on ACE firms' financial performance, negatively and positively, respectively. Hence, the findings are giving significant signals to ACE firms to improve their management in terms of leverage and stock market performances as these two factors will greatly affect their financial performance. Despite the other three factors that show insignificant influences on financial performance, ACE firms still need to be properly observing and monitoring particularly the board independence and firms' growth. Independence of board members will not only improve the firms' management and performance, but also will contribute to better corporate governance practices. In terms of growth, ACE firms' management need to be more aggressive in their production or productivity and to attract more customers to increase the sales and profit in the future. This study has shed the light on the impacts of board characteristics on ACE market firms' financial performance in addition to firms' specific factors. However, this study has merely tested on 35 listed firms in ACE market. For future research, it is recommended to test on other public listed firms in the Main market or the Leap market of Bursa Malaysia. Future research could include other firms' specific factors, board characteristics as well as macroeconomic variables such as firms' liquidity and size, board's duality and size, industrial production index (IPI) and private sectors' credit by using other types of tests as robustness. Selected independent variables, besides tested on firms' financial performance, could also be tested on firms' value, risks and stock price volatility.

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