

The Effect of Board Structure on Shareholders' Wealth in Small Listed Companies in Malaysia

Rohana Othman¹

Halimi Ponirin²

Erlane K Ghani³

Abstract: Using content analyses, this study examines whether board structure of small listed companies influence their shareholders' wealth. This study focuses on three elements of board structure, namely, board size, board composition and directors' remuneration to examine the relationship between board structure and shareholders' wealth. Shareholders' wealth is measured by the return on investment and earnings per share. The results show that out of the three elements of board structure, board size and board composition play an important role in influencing shareholders' wealth in small listed companies. The results support the findings in earlier studies that large number of directors and the proportion of executive directors in a board would instil better decision-making policy. The results in this study, however, did not support the contention that there is a significant relationship between the directors' remuneration and financial performance. The results in this study complement previous studies and provide some understanding on the importance of practicing good corporate governance.

Key words: Board structure; board size; board composition; director remuneration; shareholders' wealth; Malaysia

1. INTRODUCTION

Financial performance serves as a general measure of a company's overall financial health over a given period of time. It can be used to compare with other similar companies across the same industry or to compare industries or sectors in aggregation. Financial performance acts as an indicator to provide warning signs or corrective actions needed to improve the company's financial performance (Barry et al. 2000; Boehlje 1993). Data relating to performance measure generally could be obtained from the

¹ Universiti Teknologi MARA, Malaysia

² Universiti Teknologi MARA, Malaysia

³ Faculty of Accountancy, Universiti Teknologi MARA, Malaysia.

Email address: erlanekg@yahoo.com

* Received 18 October 2009; accepted 12 November 2009

statement of financial position, statement of financial performance and the statement of cash flow (Kay and Edwards 1994; Purdy and Langemeier 1995). One useful tool that is often being used to analyse the success, failure and progress of a company is the financial ratio measures (Barry et al. 2000; Ferguson 1990; Hasseldine et al. 2005).

With specific attention to shareholders, two common financial measures used to determine whether the amount of investment invested into a company is worthwhile are the return on investment (ROI) and earnings per share (EPS) (Barry et al., 2000). ROI is considered an important measure as it provides indication on the success of the company to provide returns to its shareholders. EPS is also an important measure to shareholders since it serves as an indicator on the amount of income generated by the company. Of consequence, the amount of income generated would determine the viability of the company. Shareholders often used these two measures in assessing their managers' ability in managing the company that they invested in and consequently, determining the quality of corporate governance practice in the company.

Mathiesen (2002) defined corporate governance as "the field in economics that investigates how to secure and motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organisational design and legislation". In layman's word, corporate governance describes the way a company is being directed and managed (Mohd Sulaiman and Bidin 2002). One crucial area of corporate governance that has received wide attention in the accounting literature is the board of directors. Board of directors is a group of people appointed by the management of a company carrying equal responsibilities of leading and directing the company with the primary objective to protect the company's shareholders' interests (Abdullah, 2004). The board of directors is responsible to assess and evaluate the appropriateness of management's strategies and approaches in transacting corporate goals (Chaganti et al. 1985; Fosberg 1989; Schellenger et al. 1989). Studies have suggested that one important criterion to ensure the success of the board of directors as managers is the board structure (Hermalin and Weisbach 1991; 2003).

Board structure distinguishes directors that hold management role in a company (executive) and directors who are not (non-executive) (Tricker, 1994). The chairman would be the top person in the board (Chin and Tai, 2001). Elements of board structure include the number and types of board committees, flow of information among these committees, committee membership and patterns of committee membership (Zahra and Pearce, 1989). Examining board structure is important since differences in board structure could affect a company's performance and of consequence, affect the viability of a company (Daily and Dalton, 1994).

The remainder of this paper is structured as follows. The next section provides a review of relevant literature. Section 3 provides the framework and hypotheses underpinning this study. Section 4 outlines the research design. The results are presented in section 5. The summary and conclusion are provided in the last section.

2. LITERATURE REVIEW

Studies have shown that there are many factors that could influence company's performance. Within the corporate governance literature, the board structure appears to be the most favoured issue examined. Most studies focused on the link between board structure and company's performance due to the growing realisation among managers and companies for the need to become internationally competitive (Andrew 1980; Harris and Raviv 2004). Another possible attribute could be due to the 1997/1998 Asia financial crisis as well as the Enron, Tyco and Adelphi scandals in 2000/2001 which has badly affected most countries. Of consequence, such financial crisis has awake the need for corporate governance restructuring among companies. This is consistent to the Malaysian Corporate Governance Code stated that the best practice in corporate governance is when the board of directors fulfil their responsibility as managers of the company (MCCG 2000). However, the effectiveness of a board of directors in fulfilling

their responsibility could be affected by the way the board is structured.

Board structure primarily consists of board size, board composition, directors' remuneration, directors' tenure, CEO duality and directors' ownership (MCCG 2000). The existence of the elements of board structure has led to the emergence of corporate governance literature. Most of the studies focused on CEO duality (such as Abdullah 2004; Dalton and Kesner 1987) and board composition (such as Chin and Tai 2001; Dalton and Daily 1999; Davis et al, 1997; Johnson et al. 1996; Zahra and Pearce 1989). However, it has been noted that three main important elements of board structure are the board size, board composition and directors' remuneration (Grinstein and Hribar 2004; Hermalin and Weisbach 1991; Pfeffer 1972).

Board size refers to the total number directors in a company (Abdullah 2004; Hermalin and Weisbach 1991). The number of directors in a board of directors of a company ranges from small to large number, with recent years, on average, the number of directors is about 20 (Morgan 2006). Within the corporate governance literature, studies have examined the effect of board size on company's performance (Bhagat and Black 1996; Chaganti et al. 1985; Yermack 1996; Zahra and Pearce, 1989). There are studies that have shown increases in board size would negatively affect company's performance (Bhagat and Black 1996; Yermack 1996; Zahra and Pearce 1989). These studies' findings are consistent to the argument of Jensen (1993) that states the increase in group size would result to a less effective performance due to the overwhelming problems in coordination and process. However, there are studies that conclude increases in board size improve company's performance (Eisenberg et al. 1998; Lanser 1969). Other studies have found no relationship between board size and performance (Van Ees et al. 2003).

A body of the literature has also examined the effect of board composition on company's performance (Baysinger and Butler 1985; Hermalin and Weisbach 1998). Board composition refers to the proportion of executive and non-executive directors in a company (Dalton and Kesner 1987; Fosberg 1989; Pfeffer 1972). The results, however, are mixed. There are studies that found positive relationship between board composition and company's performance in which larger proportion of non-executive directors lead to better performance (Baysinger and Butler 1985; Hermalin and Weisbach 1998; Pfeffer 1972). On the contrary, other studies found that more executive directors would improve performance (Kesner 1987; Vancil 1987). They found more executive directors would assist the CEO to maximise the company's value by providing advice and knowledge about the day-to-day operation. However, there are also studies that found no linkage between board composition and performance (Hermalin and Weisbach 1991).

Another body of the literature has examined directors' remuneration and its impact on company's performance. Directors' remuneration refers to the total remuneration received by the directors of a company (Firth et al. 1999; Mehran 1995)⁴. Studies that examined the link between directors' remuneration and company's performance (such as Firth et al. 1999; Mehran 1995) found that there is a positive relationship between directors' remuneration. However, in Li et al. (2005), they found excessive directors' remuneration would lead to poor performance. Of consequence, poor performance would lead to poor corporate governance practice. Other studies found no conclusive evidence (Van Ees et al. 2003).

One possible reason to the mixed findings in the corporate governance literature on board size, board composition and directors' remuneration could be attributed by the sample used. There are studies that have focused on examining large listed companies (such as Dalton and Kesner 1987; Pfeffer 1972) such as a company listed on the main board of the stock exchange. There are also studies that examined listed companies without segregating main board or second board of the stock exchange (such as Hermalin and Weisbach 1991). Other studies have focused on a particular industry such as Van Ees et al. (2003). However, the results in these studies may not represent other groups such as small listed companies. Re-examining this issue using an average or small listed companies (such as companies listed on the second board of stock exchange) could determine whether similar results shown using large listed companies would appear.

Further, most studies linking board structure and financial performance were conducted in different

⁴ This includes the salaries, fees, allowances and bonuses

setting. For example; There are studies that have used comparative setting between countries (such as Daily and Dalton 1994; Dalton and Kesner 1987; Dalton et al., 1988). Other studies have used setting in developed countries such as in USA (Kesner and Dalton 1986; Yermack 1996; Hermalin and Weisbach 1998), Russia (Peng et al. 2003), Netherlands (Van Ees et al. 2003), China (Li et al. 2007) and New Zealand (Chandler and Hershahl 1982; Turner 1985). Study on examining the link between board structure and company's performance however, is under-researched in the context of developing countries, such as in Malaysia.

In a Malaysian setting, limited studies have examined whether board structure influences company's performance (Abdullah 2004; Chang 2004; Doraisami 2003). Abdullah (2004) and Chang (2004) examined the link between board structure (CEO duality) and companies' performance. They found that there is a significant relationship between CEO duality and companies' performance. However, Abdullah's and Chang's study is limited to examination of only one element of board structure, namely, CEO duality. As noted earlier, there are other elements of board structure that could affect companies' performance and therefore, need attention. Three important elements in a board structure are the board size, board composition and directors' remuneration (Grinstein and Hribar 2004; Hermalin and Weisbach 1991; Pfeffer 1972). This study aims to examine this issue using the three elements: board size, board composition and directors' remuneration on shareholders' wealth as measured by ROI and EPS in small listed companies in Malaysia⁵. The results would provide new contribution to the corporate governance literature and shed some lights and knowledge to the management and corporate governance board on the effect of board structure on financial performance.

3. FRAMEWORK

3.1 Framework

Figure 1 illustrates the framework that underpins this study. The framework shows that board structure of a company may influence shareholder' wealth as measured by ROI and EPS. Three elements of board structure are examined in this study. The three elements of board structure are board size, board composition and directors' remuneration.

Studies have shown that shareholders often rely on financial performance measures such as ratio to determine their return on investment (Hassaldine et al. 2005). Through ratio, shareholders could determine whether the company that they have invested in practice good corporate governance. Although a large number of studies have examined the factors that influence a company's performance, the results from the studies are inconclusive. Further, most studies focused on financial performance in general, downplaying the importance of examining shareholders' wealth. In the context of this study, two performance measures that relates to shareholders' wealth are the ROI and EPS. It would be interesting to know whether the results shown in previous studies would also appear in this study. Therefore, shareholders' wealth becomes the independent variable.

Many studies have examined board size and its linkages to a company's performance (such as Abdullah 2004; Ahmed et al. 2005; Chaganti et al. 1985; Yermarck 1996). These studies have shown that board size could affect company's performance. Furthermore, larger number of executive directors in the board of directors would allow the directors to adopt higher integrity and credibility to achieve better performance. They could also share ideas and knowledge to provide effective decision-making (Eisenberg et al., 1998). However, there are studies that conclude no significant relationship between board size and company's performance (Chaganti et al. 1985; Pfeffer 1972; Van Ees et al. 2003). The

⁵ In the context of this study, small listed companies are companies that are registered in the second main of Bursa Malaysia. For a company to be listed in the second board of Bursa Malaysia, the companies must achieve the minimum aggregate after-tax profit over three to five financial years of RM12million, while the minimum after-tax profit for the most recent financial year should be RM4million.

mixed findings lead this study to re-examine this issue. Therefore, board size is the first independent variables.

Another body of the literature has suggested that board composition plays an important role in influencing positive or negative influence on companies' performance. Kesner (1987) argued that reducing the proportion of non-executive directors increases company's performance. The higher the proportion of executive directors in a board of directors, the higher would be the value of shareholders' wealth (Peng et al. 2003). This argument exists due to the fact that since executive shareholders are also the shareholders, they would strive to maximise their wealth. On the contrary, Mace (1971) and Vancil (1987) argued that more proportion of non-executive directors would be more beneficial to the company's value since they brought into the company their knowledge on functional specialist and particular technical process. Since studies in examining board composition and company's performance provide mixed findings, board composition is the second independent variable.

The last important element examined in this study is directors' remuneration. Studies have suggested that directors receiving high remuneration often performed better than directors receiving low remuneration (Firth et al. 1999; Mehran 1995). Such performance would lead to improving company's performance and shareholders' wealth. However, in Malaysia, there is yet a study that has examined whether there is relationship between directors' remuneration and shareholders' wealth and if yes, whether the relationship would appear to be positive or negative relationship. Therefore, directors' remuneration becomes the third independent variable.

3.2. Hypotheses

The development of the framework in this study consequentially led to the development of three hypotheses. Many studies have examined board size and its linkages to a company's performance (such as Abdullah 2004; Ahmed et al. 2005; Chaganti et al. 1985; Yermarck 1996). Most of these studies showed negative relationship between board size and company's performance in which smaller board size would provide higher company's performance compared to larger board size (Ahmed et. al. 2005; Yermarck 1996). There are, however, studies that found no relationship between board size and company's performance (such as Chaganti et al. 1985; Van Ees et al. 2003; Pfeffer 1972) and studies that found positive link between board size and company's performance (such as Eisenberg et al. 1998). The inconsistent findings motivate this study to re-examine this issue by focusing on shareholders' wealth. The following hypothesis is developed:

H1: There is no significant relationship between board size and shareholders' wealth

A number of studies found that a higher proportion of non-executive directors in the board would result to higher performance of the company (Baysinger and Butler 1985; Pfeffer 1972). These studies argued that non-executive directors would have less biasness in their role as a monitoring officer. On the other hand, other studies found that a higher proportion of executive directors would results better on the performance as they could communicate and liaise with the management (Kesner 1987; Peng et al. 2003). These studies argued that executive directors would assist the management in the day-to-day operations which eventuate to high level of performance. Other studies found contradictory results (Mace 1971; Vancil 1987) or no significant influence (Hermalin and Weisbach 1991; Schellenger et al. 1989). This study aims to re-examine this issue to provide more conclusive evidence. The second hypothesis is developed.

H2: There is no significant relationship between board composition and shareholders' wealth

Studies that examined directors' remuneration and its linkages to company's performance reported that there is a significant positive relationship exists between directors' remuneration and company's performance (Firth et al. 1999; Mehran, 1995). These studies showed that a company with high directors' remuneration is a reflection of the company performing well. On the other hand, no significant relationship between directors' remuneration and financial performance was found in Van Ees et al. (2003). Surprisingly, in Li et al. (2007), they found that excessive directors' remuneration reflects poor

corporate governance and would eventuate to poor company's performance. The mixed results motivate this study to re-examine this issue in a Malaysian setting. Therefore, the following hypothesis is developed.

H3: There is no significant relationship between directors' remuneration and shareholders' wealth

4. RESEARCH DESIGN

This study focuses on whether the board structure of a company influences shareholders' wealth in small listed companies. Specifically, this study aims to examine whether:

First, board size of a company influences shareholders' wealth as measured by ROI and EPS

Second, board composition of a company influences shareholders' wealth as measured by ROI and EPS.

Third, directors' remuneration influences shareholders' wealth as measured by ROI and EPS.

This study examines these issues by way of content analyses.

4.1. Sample

The companies that are registered on the second board of Bursa Malaysia are chosen as the sample study⁶. These companies are chosen because there is yet a study in Malaysia that has used this sample. Previous studies in Malaysian setting (such as Abdullah 2004; Chang 2004; Doraisami 2003) have used companies registered on the main board, Bursa Malaysia, leaving examination on companies registered on other listings largely under-researched. This study attempts to alleviate this gap by using the sample chosen.

The final sample is chosen based on stratified sampling. In determining the final sample, all companies listed on the second board of Bursa Malaysia were identified through browsing the website or from the Bursa Malaysia database. There are 298 companies listed on the Second Board, Bursa Malaysia. Out of the 298 companies, 98 companies were selected as the final sample. This number is acceptable since it represents more than 30% of the population (Sekaran 2003). The 98 companies were distributed according to its industry. Companies that are in the finance and loan sector, however, are excluded since these companies are governed by the Banking and Financial Institutions Act 1989 and therefore, would have different way of presenting their financial information. Table 1 presents the sample distribution based on stratified sampling.

4.2 Data Collection

The annual reports of the companies selected for the period 2002 to 2004 are chosen for this study. The 3 years period is considered sufficient to show the relationship between the board structure and the financial performance. Further, previous studies have used somewhat within the same period (such as Abdullah 2004; Yu et al. 2002). Data is collected primarily on the list of directors as well as the data from the statement of financial position and statement of financial performance. Specifically, the data collected relates to variables of board structure such as board size, board composition, directors' remuneration and related financial ratios such as ROI and EPS. Table 2 summarises these variables.

⁶ Bursa Malaysia is the Malaysian Stock Exchange

5. RESULTS

5.1 Descriptive Statistics of Board Structure

This section presents the descriptive statistics of the companies' board structure for the three year period 2002 to 2004. Three variables of board structure were chosen in this study, namely, board size, board composition and directors' remuneration. Their descriptive statistics for the 3 year period are shown in table 3.

Panel A, Table 3 presents the descriptive statistics of board size. The results show that on average, the number of directors in a board is 7. The results indicate that the number of directors in a board for all companies on the Second Board is similar, irrespective of the year (mean score: 7.15 in 2002; 7.07 in 2003; 7.13 in 2004). In addition, on average, the proportion of non-executive directors in a board is 55%. Such percentage is shown somewhat similar (mean score: 54% in 2002; 55% in 2003; 55% in 2004) in all the 3 year period as shown in panel B, Table 3. The results indicate that the non-executive directors in a board are generally more than the executive directors.

Panel C of Table 3 presents the descriptive statistics of directors' remuneration in the companies registered on the second board of Bursa Malaysia. The results show that the mean score of the directors' remuneration in 2002 is RM1,047,096. The mean score of the directors' remuneration has increased to RM1,44,344 in 2003 but decreased in 2004 (mean score: RM1,054,269). This is surprising since it is expected that the directors' remuneration would increase in 2004 due to the favourable economic condition in Malaysia during these period.

5.2. Descriptive Statistics of Financial Performance

This section presents the descriptive statistics of the financial performance of the companies for the three year period 2002 to 2004. Panel A of Table 4 presents the descriptive statistics of the companies' return on equity by year. The results show that on average, the level of return on equity for companies listed on the Second Board is -9.04. Specifically, the results show that the mean score of return on equity of -6.69 for year 2002 has decreased to -9.51 in 2003 and further decreased to -10.92 in 2004. The results indicate that most companies in the Second Board failed to realize an adequate return on equity invested by shareholders.

Finally, panel B of Table 4 presents the descriptive statistics of the companies' earnings per share by year. The results show that on average, the level of earnings per share for companies listed on the Second Board is -0.07 sen. The results showing mean score of earnings per share of -0.11sen in year 2002 has reduced to -0.05 sen in 2003 and the mean score remained unchanged in 2004. The results indicate that most companies in the Second Board have a lower corporate value, an indication that the companies may not be able to sell off their shares easily (Donald and Schindler 2003).

5.3. The Effect of Board Size and Shareholders' Wealth

This section presents the results of testing hypothesis 1. Hypothesis 1 states that there is no significant relationship between board size and shareholders' wealth. The Spearman's Rho test was used to test hypothesis 1⁷.

Panel A, Table 5 presents the results of the relationship between board size and ROI. The results show that there is a significant correlation ($r=0.009$). The results show that board size does have positive significant influence on shareholders' wealth in terms of ROI. The results implicate that more number of directors in a board of directors would enhance the improvement of financial performance, particularly

⁷ This analysis was used because the nature of the data is not normally distributed.

on ROI.

Panel B of Table 5 presents the results showing the relationship between the board size and EPS. The results also show that there is a significant correlation ($r=0.010$). The results indicate that more number of directors in the board of directors would further improve the company's EPS. Therefore, hypothesis 1 that states no significant relationship between board size and shareholders wealth as measured by ROI and EPS is rejected.

5.4. The Effect of Board Composition on Shareholders' Wealth

This section presents the results of testing hypothesis 2. Hypothesis 2 states that there is no significant relationship between board composition and shareholders' wealth. The Spearman's Rho test was used to test hypothesis 2.

Panel A, Table 6 presents the results of the relationship between board composition and ROI. The results show that there is a marginally significant correlation ($r=0.060$). The results show that board composition may have significant influence on shareholders' wealth in terms of ROI. The results implicate that higher proportion number of non-executive directors in a board of directors may deter the improvement of ROI.

Panel B of Table 6 presents the results showing the relationship between the board size and EPS. The results also show that there is a marginally significant correlation ($r=0.056$). The results indicate that higher proportion of executive directors in the board of directors may not improve the company's EPS. Therefore, hypothesis 2 that states no significant relationship between board composition and shareholders wealth as measured by ROI and EPS may be rejected.

5.5. The Effect of Directors' Remuneration on Shareholders' Wealth

This section presents the results of testing hypothesis 3. Hypothesis 3 states that there is no significant relationship between directors' remuneration and shareholders' wealth. The Spearman's Rho test was used to test hypothesis 3.

Panel A, Table 7 presents the results of the relationship between directors' remuneration and ROI. The results show that there is no significant correlation ($r=0.449$). The results show that directors' remuneration does not have significant influence on shareholders' wealth in terms of ROI. The results implicate that directors receiving high remuneration does not guarantee high ROI.

Panel B of Table 7 presents the results showing the relationship between directors' remuneration and EPS. The results also show that there is a no significant correlation ($r=0.269$). The results indicate that directors' receiving high remuneration does not necessarily improve EPS. Therefore, hypothesis 3 that states no significant relationship between directors' remuneration and shareholders wealth as measured by ROI and EPS is accepted.

5.6. Multiple Regression Analysis

To provide more rigorous results, a multiple regression analysis was performed to determine whether the effect of the board structure: board size, board composition and directors' remuneration would remain unchanged.

Panel A of Table 8 presents the results of the multiple regression analysis. The results show that board size influences ROI. This study indicates that the number of directors could influence the efficiency of the board in influencing the company's ROI. The results show a positive relationship between board size and return on equity ($r=0.016$). The relationship is accepted with a beta value of 51.224. Therefore, board size is an important determinant on ROI, confirming earlier results.

The results also show that board composition and directors' remuneration are not important determinants to influencing ROI. The results show that there is no significant relationship between board composition ($r=0.347$) and directors' remuneration on ROI ($r=0.584$) as shown in panel A, Table 8. The results that show board composition does not influence ROI in the multiple regression analysis could be attributed by other factors in the study. These other factors, namely the directors' remuneration has diluted the significant effect of board composition on ROI.

Panel B, Table 8 presents the results of the multiple regression analysis on the effect of board structure on EPS. The results show that board size significantly influence EPS ($r=0.048$). This study indicates that the number of directors could influence the efficiency of the board and consequentially, influence EPS. The results strengthen the significant of this factor on EPS, indicating the existment of other variables, namely, board composition and directors' remuneration did not dilute the relationship between board size and EPS. The results are accepted with a beta value of 0.592.

The results in panel B, Table 8 also show that board composition may play an important role in influencing EPS. However, the results show a negative marginally significant relationship between board composition and EPS ($r=0.087$). The results indicate that more non-executive directors in the board of the companies may deter the performance in terms of EPS. The relationship is accepted with a beta value of -0.281. The results in panel B, Table 8, however, indicate that directors' remuneration is not a significant influence on EPS ($r=0.917$). Hence, confirming the earlier results shown in this study.

6. SUMMARY AND CONCLUSION

This study examines the effect of board structure on shareholders' wealth. Three elements of board structure: board size, board composition and directors' remuneration were examined on ROI and EPS. The results show that board size influences ROI and EPS significantly. Such results indicate that more directors in a board would results in better financial performance in terms of ROI and EPS. The results in this study are consistent to previous studies that show positive relationship between board size on company's performance (Chaganti et al. 1985; Eisenberg et al. 1998). The multiple regression analyses further support the earlier results on the importance of board size as a determinant to shareholders' wealth.

The results also show that board composition plays may an important role in influencing shareholders' wealth in terms of ROI and EPS. The results showing marginally negative relationship indicate that a higher proportion of executive directors may be crucial in ensuring that all the assets are being utilised efficiently. This study supports the findings in Dalton and Kesner (1987) that found the level of return on assets becomes higher in companies having higher proportion of executive directors than non-executive directors in the board. The results implicate that executive director are important as they could convey important information to management by providing advices and knowledge on day-to-day operation (Vancil 1987). The results showing significant relationship between board composition and ROI in the multiple regression analyses provide some indication that board composition is an important determinant in shareholders' wealth when other variables exist.

The results in this study, however, did not support the contention that there is a significant relationship between the directors' remuneration and shareholders' wealth. This study implicate that a company's performance does not depend on how much the directors received their compensation but more on the number of directors in a board or the proportion of executive and non-executive directors in a board. Such results are consistent to previous studies that show no significant relationship exists between directors' remuneration and financial performance (Van Ees et al. 2003). Such results, however, are not consistent to previous studies that show higher directors' remuneration would lead to higher financial performance (Firth et al. 1999; Mehran 1995).

A key finding in this study is that board structure, particularly, board size and board composition play an important role in influencing financial performance. The evidence in this study points to the fact there

is a need to monitor and effectively organise the structure of a board to ensure good corporate governance practices is upheld.

This study has few limitations. First, this study only used data of a three year period. One may considered this as insufficient to minimize the effect of possible short-term changes in the variable values within each company. Second, this study is limited to examining three components of board structure. There are other components such as CEO duality and audit committee which are not included in this study. Examining these other factors may be potentially beneficial to enhance the model developed in this study.

Overall, the findings of this study provide useful insights on the effect of board structure on financial performance. The results in this study complement previous studies and provide some understanding on the importance of practicing good corporate governance.

REFERENCES

- Abdullah, S.N. (2004). Performance among Malaysian listed companies. *Corporate Governance*, 4, pp 47-61
- Abowd, J.M and Kaplan, D.S. (1999). Executive compensation: Six questions that need answering. NBER Working Paper Series, Paper No. 7124
- Ahmed, K; Hossain, M and Mike, A. (2005). The effects of board composition and board size on the informative of annual accounting earnings, *Online Journal*.
- Andrew, K., (1980). Directors' responsibility for corporate strategy. *Harvard Business Review*, 6, pp 30-34
- Barry, P.J; Ellinger, P.N; Hopkins, J.A and Baker, C.B. (2000) . *Financial Management in Agriculture*. Danville, Illinois: Interstate Publishers.
- Baysinger, R.D and Butler, H.N. (1985). Corporate governance and the board of directors: Performance effects of changes in boards composition. *Journal of Law, Economics and Organisation*, 1, pp 101-124
- Hermalin, H and Weisbach, M. (1991). The effect of board composition and direct incentives on firm performance. *Financial Management*, Winter, pp 101-112
- Bhagat, S and Black, B. (1996). Do independent directors matter? Working paper, Columbia University.
- Boehlje, M (1993). Some critical farm management concept. *Journal of American Society of Farm Managers and Rural Appraisers*, 57, pp 4-9
- Chang, A.L (2004). The Impact of Corporate Governance Practices on Firms' Financial Performance – Evidence from Malaysian Companies, ABI/INFORM Global, pp 308
- Chin, H and Tai, D.W (2001). Board structure, board process and board performance: A review and research agenda. *Journal of Comparative International Management*, June
- Chaganti, R.S; Mahajan, V and Sharman, S (1985). Corporate board size, composition and corporate failures in retailing industry. *Journal of Management Studies*, 22(4), pp 400-416
- Chandler, R.F. and Henshall, B.D. (1982). Corporate directorship practices in New Zealand public companies, Working Paper No. 8, The Department of Management Studies, University of Auckland
- Daily, C. and Dalton, D. (1994) Bankruptcy and corporate governance: The impact of board composition and structure. *Academy of Management Journal*, 37, pp 1603-1617.

- Dalton, D., and Daily, C. (1999). What's wrong with having friends on the board. *Across the board*, (March), pp 28-32.
- Dalton, D.F and Kesner, I.F (1987). Composition and CEO duality in boards of directors: An international perspective. *Journal of International Business Studies*, 18(3), pp 33-42
- Dalton, D.R., Kesner, I.F. and Rechner, P.L. (1988). Corporate governance and boards of directors: an international comparative perspective. *Advances in International Comparative Management*, 3, pp 95-105.
- Davis, J., Schoorman, F., and Donaldson, L. (1997). Toward a stewardship theory of management. *Academy of Management Review*, 22, pp 20-47.
- Doraisami, A (2003). The legal and financial determinants of Malaysian corporate governance. *Malaysian Journal of Economic Studies*, 1 and 2
- Eisenberg, T; Sundgren, S and Wells, M. (1998). Larger board size and decreasing firm value in small firms. *Journal of Financial Economics*, 48, pp 35-54
- Ferguson, R.C. (1990). *Managing for profit in commercial agriculture*. New Jersey: Prentice Hall
- Firth, M; Tam, M and Tang, M. (1999). The determinant of top management pay. *International Journal of Management Science*, Omega 27, 617-635
- Fosberg, R.H. (1989). Outside directors and managerial monitoring. *Akron Business and Economics Review*, 20(2), 24-32
- Grinstein, Y and Hribar, I. (2004). CEO compensation and incentives: Evidence from M&A bonuses. *Journal of Financial Economics*, 73, 119-143.
- Harris, M and Raviv, A. (2004). A theory of board control and size, <http://gsbwww.uchicago.edu/fac/Milton.harris/more>. Accessed 7 April 2009
- Hasseldine, J; Salama, A.I and Toms, J.S (2005) Quantity versus quality: the impact of environmental disclosures on the reputations of UK ples. *British Accounting Review*, 37(2), 231-248
- Hermalin, B and Weisbach, M (1998). Endogenously chosen boards of directors and their monitoring of the CEO. *American Economic Review: American Economic Association*, 88(1), 96-118
- Hermalin, B and Weisbach, M. (2003) Boards of directors as an endogenously determined institution: a survey of the economic literature. *Economic Policy Review*, Federal Reserve Bank of New York, April, 7-26
- Jensen, M.C. (1993). The modern industrial revolution, exit and the failure of the internal control system. *Journal of Finance*, 48, 831-880
- Johnson, R.A., Hoskisson, R.E. and Hitt, M.A. (1993). Board of director involvement in restructuring: the effects of board versus managerial controls and characteristics. *Strategic Management Journal*, 14, 33-50.
- Kay, R.D and Edwards, W.M (1994). *Farm Management*, New York: McGraw Hill.
- Kesner, I.F. and Dalton, D.R. (1986). Boards of directors and the checks and (im)balances of corporate governance. *Business Horizons*, 29(5), 17-23.
- Lanser, R. (1969). Visible traits of boards of directors. Unpublished doctoral dissertation. Stanford University.

- Li, D; Moshirian, F; Nguyen, P and Tan, L.W (2007). Corporate governance or globalisation: What determines CEO compensation in China?. *Research in International Business and Finance*, 21, 32-49
- Mace, M.L. (1971). *Directors, myth and reality*. Boston: Harvard Business School Press
- Malaysian Code of Corporate Governance (March 2000)
- Mathiesen, H (2002). Managerial ownership and financial performance, PhD Dissertation, Series 18, Copenhagen Business School, Denmark
- Mehran, H (1995). Executive compensation structure, ownership and firm performance. *Journal of Financial Economics*, 38, 163-184
- Mohd Sulaiman, A.M and Bidin, A. (2002). *Commercial applications of company law in Malaysia*. Singapore: CCH Asia Pte.Ltd
- Orlikoff, E and Totten, K.M (2005). The pros and cons of board compensation. *Healthcare Executive*, 20(1), 46
- Peng, M.W; Buck, T and Filatotchev, I. (2003). Do outside directors and new managers help improve firm performance?: An exploratory study in Russian privatisation. *Journal of World Business*, 38(4), 348-360
- Pfeffer, J (1972). Size and composition of corporate board of directors: The organisation and its environment. *Administrative Science Quarterly*. Singapore: Prentice Hall
- Purdy, B.M and Langemeier, M.R. (1995). Measuring farm financial performance, Kansas State University, Department of Agricultural Economics. <http://www.oznet.ksu.edu>. Accessed 30 November 2008
- Schellenger, H; Wood, D and Tashakori, A (1989). Board of directors' composition, shareholders' wealth and dividend policy. *Journal of Management*, 15(3), 457-467
- Sekaran, U (2003). *Research Methods for Business: A Skill Building Approach*. John Wiley & Sons
- Tricker, R. (1994). *International corporate governance*, Singapore: Prentice-Hall.
- Turner, R. (1985) Board of directors' leadership. *New Zealand Journal of Business*, 7, 59-62
- Van Ees, H; Postma, T and Sterken, E (2003). Board characteristics and corporate performance in the Netherlands. *Eastern Economic Journal*, Winter, 1, 41-58
- Vancil, R (1987). *Passing in baton: Managing the process of CEO succession*. Boston: Harvard School Press.
- Yermarck, D (1996). Higher market valuation of companies with a small board of directors. *Journal of Financial Economics*, 40(2), 185-212
- Yu, E; Rwegasira, K and Bilderbeek, J (2002). Corporate governance and capital structure decisions of the Chinese listed firms. *Corporate Governance: An International Review*, 10(2), 75-83
- Zahra, S., and Pearce, J. (1989). Boards of directors and corporate financial performance: A review and integrative model. *Journal of Management*, 15, 291-334.

TABLES

Table 1: Summary distribution of companies

Sector	Population N	Stratified sampling	Final sample N
Consumer product	58	40%	23
Industrial product	116	40%	46
Construction	13	40%	5
Trading/ services	53	40%	21
Property	3	40%	1
Plantation	3	40%	1
Technology	3	40%	1
TOTAL	298	40%	98

Table 2: Variables constructs used in this study

Variable:	Definition	Previous studies
<u>Dependent:</u>		
Return on equity (ROE)	To measure performance on invested capital.	Peng et al. (2003)
Earnings per share (EPS)	To measure performance on operation and profitability.	Ahmed et al. (2005)
<u>Independent:</u>		
Board size	Number of directors in a board.	Yu et al. (2002)
Board composition	The proportion of non-executive directors to total number of directors.	Schellenger et al., 1989; Hermalin and Weisbach, 1991
Directors' remuneration	The amount of salaries, bonuses, allowances and fees.	Abowd and Kaplan (1999); Orlikoff and Totten (2005)

Table 3: Descriptive Statistics of Board Structure

Panel A: Descriptive Statistic of Board Size

Variable: Board Size	Mean Number of Directors	Standard Deviation
2004	7.13	1.34
2003	7.07	1.41
2002	7.15	1.42

Panel B: Descriptive Statistic of Board Composition

Variable: Board Composition	Mean	Percentage of Non-Executive Directors	Standard Deviation
2004	54.96		16.50
2003	55.13		15.59
2002	54.01		15.70

Panel C: Descriptive Statistic of Directors' Remuneration

Variable: Directors' remuneration	Mean Percentage of RM	Standard Deviation
2004	1,054,268.54	785,053.05
2003	1,144,343.93	1,069,495.80
2002	1,047,095.69	866,397.82

Table 4: Descriptive statistics of Financial Performance

Panel A: Companies' ROE by year

Sector	N	Mean	Median	Standard Deviation
2004	98	-10.92	0.80	37.37
2003	98	-9.51	0.19	28.98
2002	98	-6.69	1.30	28.23

Panel B: Companies' EPS by year

Sector	N	Mean Sen	Median	Standard Deviation
2004	98	-0.05	0.01	0.20
2003	98	-0.05	0.00	0.60
2002	98	-0.11	0.02	0.46

Table 5: Effect of board size on shareholders' wealth

Panel A: Board size and ROI

			ROI
Spearman's Rho	Board Size	Correlation coefficient	0.261
		Sig. (2-tailed)	0.009
		N	98

Panel B: Board size and EPS

			ROI
Spearman's Rho	Board Size	Correlation coefficient	0.258
		Sig. (2-tailed)	0.010
		N	98

Table 6: Effect of Board Composition on shareholders' wealth

Panel A: Board size and ROI

			ROI
Spearman's Rho	Board Composition	Correlation coefficient	-0.191
		Sig. (2-tailed)	0.060
		N	98

Panel B: Board size and EPS			ROI
Spearman's Rho	Board Composition	Correlation coefficient	-0.194
		Sig. (2-tailed)	0.056
		N	98

Table 7: Effect of Directors' Remuneration on shareholders' wealth

Panel A: Board size and ROI			ROI
Spearman's Rho	Directors' Remuneration	Correlation coefficient	0.069
		Sig. (2-tailed)	0.449
		N	98

Panel B: Board size and EPS			ROI
Spearman's Rho	Directors' Remuneration	Correlation coefficient	0.113
		Sig. (2-tailed)	0.269
		N	98

Table 8

Panel A: Multiple Regression analysis for ROI		
	Unstandardised Coefficient Beta	Sig.
Intercept	-45.056	0.020
BSIZE	51.224	0.016
BCOMP	-10.957	0.347
DREM	-1.120E-06	0.584

Panel B: Multiple Regression Analysis for EPS		
Model	Beta	Sig.
Intercept	-0.413	0.128
BSIZE	0.592	0.048
BCOMP	-0.281	0.087
DREM	-2.991E-09	0.917

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.