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DO MUSLIM DIRECTORS INFLUENCE FIRM PERFORMANCE? EMPIRICAL EVIDENCE FROM MALAYSIA[1]

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Abstract

This study examines the impact of several corporate governance mechanisms on the performance of firms in Malaysia. Giving particular attention on board diversity, this study looks into the impact of Muslim directors in the board of directors (BoD) on firm performance. It is found that the presence of Muslim directors in the BoD does have a significant impact on the performance of the firms and can bring the firm to its utmost performance. Board independence seems to coexist with CEO duality in pursuing maximum firm value and directors' remuneration does not seem to be the driver and motivator to achieve good firm performance. Board size is also taken into consideration when devising corporate governance structure where the larger the size of the board the better performance it is for the firms. Policy makers and other responsible players should take into account the mechanisms discussed in this study when structuring corporate governance. This study fills the gap and contributes significantly to the literature by proving extensive findings with regards to the impact of corporate governance on firms' performance especially the presence of Muslim directors in BoD in Malaysia.

Keywords: Muslim Directors, Board of Directors, Governance, Islamic Finance

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1.0 Introduction

Board composition has been acknowledged as one vital element that strikes the interests of many players when discussing corporate governance issues. Firms are believed to perform to their utmost level of efficiency when there is a diverse yet balance board composition [2]. Board composition affects firm performance significantly as board of directors (BoD) are top level management responsible in strategizing goals and achievements[3]. A sound board composition leads to effective corporate governance which will consequently improve firm performance and ultimately increase firm value. Poor corporate governance and mismanagement in a firm will definitely lead to a disaster and the firm will finally collapse. This is evidenced by the collapse of many high-profile scandals like WorldCom, Enron and Adelphia and poor corporate governance was said to be the culprit. All players and policy makers then started to embark into in depth investigation on the issue of corporate governance in striving for much better and effective corporate governance structure[4].

For the past few decades literature sees the trend of the investigation on the issue of corporate governance mainly dominated by the developed market[5]. Not until the devastating financial turmoil hitting many countries especially in the Southeast Asian region in 1997/98 that the attention shifted to that of the emerging market. The economy of many countries was badly affected and consequently collapsed too. Startled by the bad hit, policy makers and managers

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[2] R. Hassan and M. Marimuthu, "Corporate Governance, Board Diversity, and Firm Value: Examining Large Companies using Panel Data Approach", *Economics Bulletin*, 36(3), (2016), 1737-1750.

[3] M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure", *Journal of Financial Economics*, 3(1), (1976), 305-360.

[4] B. S. Black, A. G. De Carvalho, W. Kim, V. S. Khanna and B. B. Yurtoglu, "Methods for Multicountry Studies of Corporate Governance: Evidence from the BRIKT Countries", *Journal of Econometrics*, 183(2), (2014), 230-240.

[5] P. R. Bhatt and R. Bhatt, "Corporate Governance and Firm Performance in Malaysia", *Corporate Governance: The International Journal of Business in Society*, 17(5), (2017), 896-912.

started to examine and investigate the corporate governance structure then which were seriously condemned, questioned and debated thus demanded urgent restructuring[6]. Malaysia was badly hit by the financial crisis in 1997/98 as well and was also caused by poor practices of corporate governance[7]. It is acknowledged that there is no one fits it all code of corporate governance as every economy has its own individual characteristics thus corporate governance structured needs to suit each firm in each economic standing individually[8].

Agreeing to the above, this study intends to investigate further what attributes to a good effective corporate governance in Malaysia, being a country with diversity in terms of cultures, races, ethnics and religions. Going back to the element of board composition, how diverse a board composition constitutes to a good corporate governance and Malaysia offers such good setting for this investigation. With this respect, this study intends to enrich and fill the gap in the literature by examining and investigating whether the presence of Muslim directors in the board contributes to good firm performance as Muslims constitutes the biggest portion in the pie of population in Malaysia which is 61.3%[9]. BoD plays an important task in monitoring optimum performance of the top management as to make sure that the management will act in the best interest of the shareholders or owners[10]. Board diversity encourages board independence and board independence is claimed to have good impact on firm performance (Hassan and Marimuthu, 2016)[11].

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6 B. S. Black, A. G. De Carvalho, W. Kim, V. S. Khanna and B.B. Yurtoglu, "Methods for Multicountry Studies of Corporate Governance: Evidence from the BRIKT Countries", op. cit.

7 T. Mitton, "A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis", *Journal of Financial Economics*, 642(1), (2002), 215-241.

8 B. S. Black, A. G. De Carvalho, W. Kim, V. S. Khanna and B. B. Yurtoglu, "Methods for Multicountry Studies of Corporate Governance: Evidence from the BRIKT Countries", op. cit.

9 Department of Statistics Malaysia, (2018), accessed on July 18, 2018, https://www.dosm.gov.my/v1/

10 M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure", op. cit.

11 R. Hassan and M. Marimuthu, "Corporate Governance, Board Diversity,

Performance is then maximized, value enhanced and ultimately wealth is escalated tremendously.

Literature notices the impact of ethnic diversity in the BoD where ethnic diversity among the BoD enhances effective and efficient management and responsibilities are carried out perfectly[12]. Hence, this study aims to study the influence of Muslim directors in the BoD on firm performance being the biggest ethnic and religion in Malaysia. The impact of having Muslim directors in the BoD of firms in Malaysia has not been established in the literature, thus this study intends to do so. Not many thorough examinations have been made regarding the influence of Muslim directors/CEOs in the BoD on firm performance in Malaysia. Besides, the existing literature on this issue mainly uses a fairly sufficient data to represent the general atmosphere of this relationship. It is either a moderate number of firms within a one-year observation, or up to at least five years observations with a limited number of firms being examined. This is mainly due to the limitation in collecting data on board of directors of firms which can only be accessed through firms' annual reports. Therefore, responding to this scenario, this study aims to investigate the influence of Muslim directors in the BoD of firms in Malaysia by using 743 firms over 16 years with observations from 2000-2015. This study uses the Generalize Methods of Moment (GMM) in its analysis as this method can tackle the endogeneity issue which is generally neglected in the existing literature when addressing firm level corporate governance[13]. To recapitulate, this study offers several contributions to the body of knowledge not only on the impact of Muslim directors on firm performance in Malaysia using a wide span of study period and substantial numbers of observations for a better generalization. Besides board composition, this study will also look into the impact of CEO duality, board independence, ownership concentration, board size and directors' remuneration on

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and Firm Value: Examining Large Companies using Panel Data Approach", op. cit.

[12] Ibid.

[13] C. W. Hooy and R. Ali, "Does A Muslim CEO Matter in *Shari'ah*-Compliant Companies? Evidence from Malaysia", *Pacific-Basin Finance Journal*, 42(1), (2017), 126-141.

firm performance while controlling for some firm level determinants like firm size, leverage, growth and age of firms. The results and findings will help establishing the influence of the board composition especially the presence of Muslim directors in the BoD of firms in Malaysia for record in the literature thus will help policy makers as well as other players in strategizing good corporate governance with regard to board composition and diversity. This study will also fill the gap in the literature without ignoring the endogeneity issue which is a quite common issue being neglected[14].

The rest of this study is organized as follows. The next section deals with the literature review of related studies on corporate governance particularly board diversity and composition and the development of the hypotheses then follows by the data and methodology of the study. The section proceeds to results and analysis of findings and the last section concludes the study with some policy implications discussed.

2.0 Literature Review and Hypotheses Development

2.1 The Malaysian Code of Corporate Governance (MCCG)

Considering the dire need of effective and sound corporate governance after being severely affected by the financial crisis in 1997, the Securities Commission (SC) of Malaysia has come out with a Malaysian Code on Corporate Governance (MCCG) in 2000. Being a significant tool for corporate governance reform, the code is forecasted to positively impact corporate governance practices in Malaysia. In 2007, the MCCG was reviewed to strengthen the roles and responsibilities of the board of directors, audit committee and the internal audit function as to ensure it remains relevant and aligned with current practices globally. The MCCG was reviewed again in 2012 to augment board structure and composition. Listed Malaysian companies were required to report on their compliance with the principles and recommendations of MCCG (2012)[15] in their annual

[14] P. R. Bhatt and R. Bhatt, "Corporate Governance and Firm Performance in Malaysia", op. cit.

[15] MCCG (2012), accessed on July 20, 2018, http://micg.org.my/upload/file/articles/11/CODE-CG- 2012.pdf

reports. In 2017, a new version and a much better revised MCCG supersedes its earlier editions and embarks on a new approach to promote greater internalisation of corporate governance culture. It includes duties and responsibilities of board of directors to influence firm performance, like reviewing and adopting a strategic plan, adequacy and the integrity of the company's internal control systems[16].

There are four popular theories when discussing the issues of corporate governance, which are the agency theory, the stewardship theory, the stakeholder theory and the resource dependency theory[17]. The four theories emphasize on different functions of a board. Putting concern on the conflict of interest between managers and shareholders, the agency theory highlights the monitoring mechanism of the board[18]. Stakeholder theory focuses on the problems concerning the interests of stakeholders thus sees the board as representative of stakeholders[19]. Stewardship theory views managers as trustworthy agent making monitoring acts from the board less important[20]. Finally, resource dependency theory highlights board as resources of information and linkage to outside information thus ensures long term prospects to the firm[21].

2.2 Past Studies on Corporate Governance and Firm performance

Empirical evidences document a strong relationship between board

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[16] MCCG (2017), https://www.sc.com.my/wp-content/uploads/eng/html/cg/mccg2017.pdf, accessed on July 20, 2018.

[17] A. U. Sanda, A. S. Mikailu and T. Garba, "Corporate Governance Mechanisms and Firm Financial Performance in Nigeria", *AERC Research Paper*, No.149, (2005).

[18] M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure", op. cit.

[19] R. E. Freeman, *Strategic Management: A Stakeholder Approach*, (Boston, MA: Pitman, 1984).

[20] L. Donaldson and J. H. Davis, "Stewardship Theory or Agency Theory: Corporate Governance Shareholder Returns", *Australian Journal of Management*, 16(1), (1991), 49-64.

[21] M. Carpenter and J. Westphal, "The Strategic Context of External Network Ties: Examining the Impact of Board Appointments on Board Involvement in Strategic Decision Making", *Academy of Management Journal*, 44, (2001), 639–660.

diversity and firm performance[22]. The more diversified a board is, the higher the firm performance will be. Following this notion, diversification in terms of cultural, racial, religion, societal and gender have been discussed and studied quite extensively (Lückerath-Rovers, 2013)[23] for diversity could lead to a firm's competitive advantage. In terms of corporate decision, it is argued that corporate decision is very much affected by religiosity of the individual director (McGuire *et al.*, 2012)[24], by means that as documented by Kennedy & Lawton (1998)[25], religion appears to have significant effect in the choices and decisions of corporate managers in societies where the influence of religion is high. Evidenced by a recent study by Volonte (2015)[26] social norms shared specifically among these religious people apparently have substantial influence on the corporate governance mechanisms the firm adopts. Responding to this, this study intends to study the influence of Muslim directors in the BoD on firm performance as Muslim is the biggest population in Malaysia and Ahmad (2011)[27] states that Islam highly emphasizes humans' ethical value based on divine commands and guidelines. The ethical characteristics expected of a Muslim director should encourage good corporate governance mechanism thus much lesser monitoring is needed (Alhabshi, 1994)[28]

[22] R. Hassan and M. Marimuthu, "Corporate Governance, Board Diversity, and Firm Value: Examining Large Companies using Panel Data Approach", op. cit.

[23] M. Lückerath-Rovers, "Women on Boards and Firm Performance", *Journal of Management and Governance*, 17(2), (2013), 491-509.

[24] J. McGuire, S. Dow and B. Ibrahim, "All in the Family? Social Performance and Corporate Governance in the Family Firm", *Journal of Business Research*, 65(11), (2012), 1643-1650.

[25] E. J. Kennedy and L. Lawton, "Religiousness and Business Ethics", *Journal of Business Ethics*, 17(2), (1998), 163-175.

[26] C. Volonte, "Culture and Corporate Governance: The Influence of Language and Religion in Switzerland", *Management International Review*, 55(1), (2015), 77-108.

[27] M. S. Ahmad, "Work Ethics: An Islamic Prospective", *Journal of Human Sciences*, 8(1), (2011), 850-859.

[28] S. O. Alhabshi, "Islamic Values: Its Universal Nature and Applicability", published in S. O. Alhabshi & A. H. Ghazali (Eds.), (Kuala Lumpur: Islamic

and will focus on improving firm performance rather than accumulating wealth at the expense of other shareholders. Nevertheless, Guiso *et al*. (2003)[29] argue that the concept of brotherhood, one of the ethical principles in Islam encourages social responsibility and avoids competition among his brothers in the market. Hence Muslim directors might exhibit a more conservative behaviour in running a business, thus lowering firm performance[30].

The literature has been documenting inconclusive results regarding the relationship between the governance measurements (board size, board independence, Muslim director, CEO duality, director remuneration and ownership structure) and firm performance. McConnell and Serveas (1990)[31] find that ownership concentration relates positively with firm performance. However, Demsetz and Villalonga (2001)[32] do not find any relationship between ownership structure and firm performance. Sheikh *et al*. (2013)[33] and Mishra and Kapil (2017)[34] document a positive relationship between ownership and firm performance and board size relates positively with performance as well. Yammeesri and Herath (2010)[35] report that firms with a large board size tend to appoint the CEO as the Chairman of the board while CEO duality appears to be

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Values and Management. Institute of Islamic Understanding Malaysia (IKIM), 1994), 7–22.

[29] L. Guiso, P. Sapienza and L. Zingales, "People's Opium? Religion and Economic Attitudes", *Journal Monetary Economy*, 50, (2003), 225-282.

[30] Ibid.

[31] J. McConnell and H. Serveas, "Additional Evidence on Equity Ownership and Corporate Value", *Journal of Financial Economics*, 27(2), (1990), 595-612.

[32] H. Demsetz and B. Villalonga, "Ownership Structure and Corporate Performance", *Journal of Corporate Finance*, 7(3), (2001), 209-233.

[33] N. A. Sheikh, Z. Wang and S. Khan, "The Impact of Internal Attributes of Corporate Governance on Firm Performance: Evidence from Pakistan", *International Journal of Commerce and Management*, 23(1), (2013), 38-55.

[34] R. Mishra and S. Kapil, "Effect of Ownership Structure and Board Structure on Firm Value: Evidence from India", *Corporate Governance: The International Journal of Business in Society*, 17(4), (2017), 700-726.

[35] J. Yammeesri and S. K. Herath, "Board Characteristics and Corporate Value: Evidence from Thailand", *Corporate Governance: The International Journal of Business in Society*, 10(2), (2010), 279-292.

connected to the appointment of fewer inside directors and more grey directors. Lam and Lee (2008)[36] suggests that family control influences the relationship between CEO duality and accounting performance while CEO duality is good for non-family firms. Christensen *et al*. (2010)[37] on the other hand, find a negative relationship between large board size and CEO duality with firm performance when return on assets (ROA) is used, but positive relationship when Tobin's Q is used. A contrasting result is found by Arora and Sharma (2016)[38] where CEO duality does not have any influence on firm performance of firms in India. Looking at remuneration and firm performance, better remuneration is an effective catalyst for a better firm performance. Fama and Jensen (1983)[39] explain that attractive incentive in the form of remuneration given to the BoD tends to mitigate agency problem and enhance firm performance and literature seems to support this view (see, for an example: Ahad *et al*., 2018)[40].

Yermack (1996)[41] and Klein (1998)[42] share similar findings that board independence affects firm performance negatively. Farhan *et al*. (2017)[43] confirms the negative relationship when they study

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[36] T. Y. Lam and S. K. Lee, "CEO Duality and Firm Performance: Evidence from Hong Kong", *Corporate Governance: The International Journal of Business in Society*, 8(3), (2008), 299-316.
[37] J. Christensen, P. Kent and J. Stewart, "Corporate Governance and Company Performance in Australia", *Australian Accounting Review*, 20(55), (2010), 372-386.
[38] A. Arora and C. Sharma, "Corporate Governance and Firm Performance in Developing Countries: Evidence from India", *Corporate Governance: The International Journal of Business in Society*, 16(2), (2016), 420-436.
[39] E. F. Fama and M. C. Jensen, "Separation of Ownership and Control", *Journal Law Economic*, 26(1), (1983), 301-325.
[40] M. Nur-Al-Ahad and M. A. Rahman, "Nexus between Directors' Remuneration and Performance in Malaysia: A Supervised Machine Learning Approach", *Journal of International Business and Management*, 1(2), (2018), 1-14.
[41] D. Yermack, "Higher Market Valuation of Companies with a Small Board of Directors", *Journal of Financial Economics*, 40(4), (1996), 185-211.
[42] A. Klein, "Firm Performance and Board Committee Structure", *The Journal of Law and Economics*, 41(1), (1998), 275-304.
[43] A. Farhan, S. N. Obaid and H. Azlan, "Corporate Governance Effect on

the relationship between corporate governance and firm performance in the United Arab Emirates (UAE). However, Mashayekhi and Bazaz (2008)[44] depict a significant positive relationship between board independence and firm performance in Iran. Rodriguez-Fernandez *et al*. (2014)[45] on the other hand are not able to confirm any significant relationship between board independence and CEO duality and firm performance. Adewuyi and Olowookere (2013)[46] stress that having more independent directors in the board reduce firms' performance in Nigeria and their study confirms that notion.

Looking at the Malaysian context, Leng (2004)[47] depicts significant relationship between board size and the performance of 77 listed firms over the period 1996-1999. Mohd Ghazali (2010)[48] however, cannot confirm a significant relationship between board size and performance. Ponnu (2008)[49] also fails to share evidence of significant relationship between corporate governance and firm performance after the implementation of the MCCG 2000. This implies that the implementation of MCCG does not have substantial influence on the performance of firms in the context of Malaysian

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Firms' Performance - Evidence from the U.A.E.", *Journal of Economic and Administrative Sciences*, 33(1), (2017), 66-80.

[44] B. Mashayekhi and M. S. Bazaz, "Corporate Governance and Firm Performance in Iran", *Journal of Contemporary Accounting & Economics*, 4(2), (2008), 156-172.

[45] M. Rodriguez-Fernandez, S. Fernandez-Alonso and J. Rodriguez-Rodriguez, "Board Characteristics and Firm Performance in Spain", *Corporate Governance*, 14(4), (2014), 485-503.

[46] A. O. Adewuyi and A. E. Olowookere, "New Corporate Code and Immediate Performance Change of the Nigerian Firms", *Corporate Governance: The international Journal of Business in Society*, 13(2), (2013), 169-183.

[47] A. C. A. Leng, "The Impact of Corporate Governance Practices on Firms' Financial Performance: Evidence from Malaysian Companies", *ASEAN Economic Bulletin*, 21(3), (2004), 308-318.

[48] N. A. Mohd Ghazali, "Ownership Structure, Corporate Governance and Corporate Performance in Malaysia", *International Journal of Commerce and Management*, 20(2), (2010), 109-119.

[49] C. Y. Ponnu, "Corporate Governance Structures and the Performance of Malaysian Public Listed Companies", *International Review of Business Research Papers*, 4(2), (2008), 217–230.

public-listed firms then. A contrasting finding is nevertheless documented by Che Haat *et al*. (2008)[50] in their study of 142 Malaysian firms in 2002 where a more favourable reaction of firm performance after the implementation of the MCCG. Corporate governance does matter for the firms to perform at its best. A recent study by Shawtari *et al*. (2017)[51] find board size, CEO duality and board independence do have significant impact on firm performance. Rahman and Haniffa (2005)[52] report that Malaysian firms with CEO duality do not perform as well as firms without duality. Bhatt and Bhatt (2017)[53] on the other hand, use a self-developed corporate governance index and report that the performance of the firm is positively and significantly related with corporate governance. Hooi and Ali (2017)[54] report that firms with Muslim CEOs present significantly lower performance in comparison with non-Muslim CEOs. Meanwhile, Ahad *et al*. (2018)[55] observe that good remuneration for the BoD results in good firm performance in Malaysia. The MCCG proposes that a fair remuneration is a way to attract and motivate directors[56].

The inconclusiveness on the relationship between several important elements in corporate governance and firm performance

[50] M. H. Che Haat, R. Abdul Rahman and S. Mahenthiran, "Corporate Governance, Transparency and Performance of Malaysian Companies", *Managerial Auditing Journal*, 23(8), (2008), 744-778.
[51] F. A. Shawtari, M.H.S. Mohamad, A. R. M. Hafiz and M. A. Abdullah, "Board Characteristics and Real Performance in Malaysian State-Owned Enterprises (SOEs)", *International Journal of Productivity and Performance Management*, 66(8), (2017), 1064-1086.
[52] R. A. Rahman and R. M. Haniffa, "The Effect of Role Duality on Corporate Performance in Malaysia", *Corporate Ownership and Control*, 2(2), (2005), 40-47.
[53] P. R. Bhatt and R. Bhatt, "Corporate Governance and Firm Performance in Malaysia", op. cit.
[54] C.W. Hooy and R. Ali, "Does A Muslim CEO Matter in *Shari'ah*-Compliant Companies? Evidence from Malaysia", op. cit.
[55] M. Nur-Al-Ahad and M.A. Rahman, "Nexus between Directors' Remuneration and Performance in Malaysia: A Supervised Machine Learning Approach", op. cit.
[56] T. Yoshikawa, *Asian Corporate Governance: Trends and Challenges*, (Cambridge: Cambridge University Press, 2018).

demands further examinations and investigations especially in Malaysia. Therefore, this study attempts to scrutinize further this relationship specifically on the impact of Muslim directors over firm performance.

3.0 The Corporate Governance Mechanisms and Hypotheses Development

To meet the objective of this study, the corporate governance mechanisms incorporated in this study are Muslim director, size of the board, board independence, CEO duality, director remuneration and ownership structure while controlling several firm level determinants of firm performance like firm size, leverage, growth and age of firm.

3.1 Muslim Director

Literature generally witnesses religion to have significant impact on corporate governance decisions as evidenced by Volonte (2015)[57]. Kim and Daniel (2016)[58] assert that certain ethical values commonly shared among Muslim directors give significant impact on the corporate governance structures the firm adopts. Islam is very sensitive towards humans' ethical value guided by *Shari'ah* principles (Ahmad, 2001)[59] thus is expected to encourage good corporate governance mechanism and may reduce monitoring cost (Alhabshi, 1994)[60] and will focus on improving firm performance rather than accumulating wealth at the expense of other shareholders. This poses a positive relationship between Muslim directors and firm performance. Nevertheless, Guiso *et al*. (2003)[61] argue that the concept of brotherhood, one of the ethical principles in Islam

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[57] C. Volonte, "Culture and Corporate Governance: The Influence of Language and Religion in Switzerland", op. cit.

[58] J. Kim and S. J. Daniel, "Religion and Corporate Governance: Evidence from 32 Countries", *Asia-Pacific Journal of Financial Studies*, 45(2), (2016), 281-308.

[59] M. S. Ahmad, "Work Ethics: An Islamic Prospective", op. cit.

[60] S. O. Alhabshi, "Islamic Values: Its Universal Nature and Applicability", op. cit.

[61] L. Guiso, P. Sapienza and L. Zingales, "People's Opium? Religion and Economic Attitudes", op. cit.

encourages social responsibility and avoids competition among his brothers in the market. Hence Muslim directors might exhibit a more conservative behaviour in running a business, thus lowering firm performance (Guiso *et al*., 2003)[62] hence a negative relationship is expected. The hypothesis is,

> *H_1: There is a positive relationship between Muslim director and firm performance.*

3.2 Director Remuneration

Looking at remuneration and firm performance, better remuneration is an effective catalyst for a better firm performance. Fama and Jensen (1983)[63] explain that attractive incentive in the form of remuneration given to the BoD tends to mitigate agency problem and enhance firm performance and literature seems to support this view (Ahad *et al*., 2018)[64] thus a positive relationship. In the Malaysian context, Ismail *et al*. (2014)[65] report a positive relationship between director remuneration and firm performance among listed firms. Nonetheless, Abdullah (2006)[66] reveals that among distressed companies in Malaysia, directors' remuneration does not have any association with firm's profitability as measured by return of assets (ROA). However, Hassan *et al*. (2003)[67] argue that remuneration is less effective to improve firm performance among family owned firm because of conflict of interest that exists between the majority and minority shareholders. Most firms are reported to be dominated by

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[62] Ibid.

[63] E. F. Fama and M. C. Jensen, "Separation of Ownership and Control", op. cit.

[64] M. Nur-Al-Ahad and M A. Rahman, "Nexus between Directors' Remuneration and Performance in Malaysia: A Supervised Machine Learning Approach", op. cit.

[65] S. Ismail, N. Yabai and L. Hahn, "The Relationship between CEO Pay and Firm Performance: Evidence from Malaysia Listed Firms", *IOSR Journal of Economics and Finance*, 3(6), (2014), 14-31.

[66] S. N. Abdullah, "Directors' Remuneration, Firm's Performance and Corporate Governance in Malaysia among Distressed Companies", *Corporate Governance: The International Journal of Business in Society*, 6(2), (2006), 162-174.

[67] S. Hassan and C. Theo, "Directors' Remuneration and Firm Performance: Malaysian Evidence", *Malaysian Accounting Review*, 2(1), (2003), 57-67.

family even more so in emerging countries[68]. Dogan and Smyth (2001)[69] however depict an ambiguous relationship between director remuneration and firm performance over the period 1989-2000. According to Ben *et al*. (2013)[70], director remuneration negatively influences firm performance among Kenyan listed companies.

> *H_2: There is a positive relationship between director remuneration and firm performance.*

3.3 Board size

The size of board refers to the number of board members (executives and non-executives) where a reasonable board size has been more effective in controlling the firm, while a bigger board has a negative effect on firms' performance[71] thus leads to a negative relationship with performance. Bigger size of board also delays communications thus may delay decision making. However, Sun *et al*. (2014)[72] claim that large board can increase monitoring and offer collective advice to the CEO thus increase firm performance, a positive relationship. Chugh *et al*. (2011)[73] add that larger board leads to more collective and comprehensive decision based more resources from different

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[68] R. Haron, "Firm Level, Ownership Concentration and Industry Level Determinants of Capital Structure in an Emerging Market: Indonesia Evidence", *Asian Academy of Management Journal of Accounting and Finance*, 14(1), (2018), 127-151.

[69] E. Dogan and R. Smyth, "Board Remuneration, Company Performance, and Ownership Concentration: Evidence from Publicly Listed Malaysian Companies", *Asian Economic Bulletin*, 19(3), (2002), 319-347.

[70] M. Ben, O. Cliff Osoro and M. Julius, "The Relationship between Director Remuneration and Performance of Firms Listed in the Nairobi Securities Exchange", *International Journal of Social Sciences*, (2013), 15(1), 1-17.

[71] R. García-Ramos and M. García-Olalla, "Board Characteristics and Firm Performance in Public Founder-and Nonfounder-led Family Businesses." *Journal of Family Business Strategy*, 2(4), (2011), 220-231.

[72] J. Sun, G. Lan and G. Liu, "Independent Audit Committee Characteristics and Real Earnings Management", *Managerial Auditing Journal*, 29(2), (2014), 153-172.

[73] L. C. Chugh, J.W. Meador and A.S. Kumar, "Corporate Governance and Firm Performance: Evidence from India", *Journal of Finance and Accountancy*, 7(1), (2011), 1-10.

board members. In addition, Haniffa and Hudaib (2006)[74] have found that the board size adds more experience and enhances the firms' performance.

> *H_3: There is a positive relationship between board size and firm performance.*

3.4 Board Independence

Fama and Jensen (1983)[75] opine that outside board of directors could enhance firm value by sharing experience and offering monitoring services over the manager. O'Connell and Cramer (2010)[76] record a positive effect of board independence on firms' performance. Higher proportion of independent directors is expected to provide effective monitoring of the management, and thereby improve firm performance[77]. Agency theory supports the positive relationship between the board independence with firm performance. On the contrary, Chugh *et al*. (2011)[78] establish that a high percentage of independent directors decrease firm performance.

> *H_4: There is a positive relationship between board independence and firm performance.*

3.5 CEO Duality

Duality of a CEO occurs when the CEO is also holding a position as a Chairman of the board[79]. The literature argues that the status of

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[74] R. Haniffa and M. Hudaib, "Corporate Governance Structure and Performance of Malaysian Listed Companies", *Journal of Business Finance and Accounting*, 33(7-8), (2006), 1034-1062.
[75] E. F. Fama and M. C. Jensen, "Separation of Ownership and Control", op. cit.
[76] V. O'Connell and N. Cramer, "The Relationship between Firm Performance and Board Characteristics in Ireland", *European Management Journal*, 28(5), (2010), 387-399.
[77] E. F. Fama and M. C. Jensen, "Separation of Ownership and Control", op. cit.
[78] L. C. Chugh, J. W. Meador and A. S. Kumar, "Corporate Governance and Firm Performance: Evidence from India", op. cit.
[79] J. Yammeesri and S. K. Herath, "Board Characteristics and Corporate Value: Evidence from Thailand", op. cit.

CEO has direct impact on governance of firms[80]. CEO position should be independent of the chairperson of the board to enable balance and check on misuse of power by the same. CEO duality may increase the conflict of interest, and the agency cost increases when CEO and the board chair is the same person thus a negative relationship is expected. Contrary to this view, Rechner and Dalton (1991)[81] argue that CEO duality would provide better incentives by linking CEO pay which will affect the firms' performance. The stewardship theory on the other hand argues that separating the two roles between two different people may lead to competition and conflict between them[82]. CEO duality ensures concentrated power in one hand to avoid conflicts of interest when monitoring and advising manager in making important decision to enhance firm performance. Klein (2002)[83] finds that role duality leads to unchecked powers and finds a significant positive association with firm performance. Therefore,

> *H_5: There is a negative relationship between CEO duality and firm performance.*

3.6 Ownership Concentration

Ownership concentration can be a solution to agency problem and may improve firm performance, hence a positive relationship. Controlling shareholders are in a better position to monitor and take action against managers, which can lead to better firm performance[84]. Empirical studies also indicate that ownership concentration is

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[80] F. A. Shawtari, M.H.S. Mohamad, A. R. M. Hafiz and M. A. Abdullah, "Board Characteristics and Real Performance in Malaysian State-Owned Enterprises (SOEs)", op. cit.

[81] P. L. Rechner and D. R. Dalton, "CEO Duality and Organisational Performance: a Longitudinal Analysis", *Strategic Management Journal*, 12(2), (1991), 155-160.

[82] M. B. Condit and E. D. Hess, "Is it Time for the Non-Executive Chairman?" *The Corporate Board*, 23(1), (2003), 7-10.

[83] A. Klein, "Audit Committee, Board of Director Characteristics, and Earnings Management", *Journal of Accounting and Economics*, 33(3), (2002), 375-400.

[84] R. Mishra and S. Kapil, *Corporate Governance: The International Journal of Business in Society*, (2017), 700-726.

positively related to performance (see for an example; Sheikh *et al.*, 2013)[85]. Lehmann and Weigand (2000)[86] however find a negative relationship between ownership concentration and firm's performance.

> *H_6: There is a positive relationship between ownership concentration and firm performance.*

4.0 Data and Methodology

This study utilizes an unbalanced panel data that included 743 Malaysian listed firms covering the 16 years period of 2000-2015. The firms' data on governance are manually collected from the annual reports of the firms since it is not available on on-line database. The annual reports are downloaded from the Bursa Malaysia website, while data on controlled variables are extracted from the Datastream database. Only firms that have been listed on Bursa Malaysia from 2013 are included in the study sample.

This study performs a panel regression to examine the influence of governance variables on firm performance after controlling for firm size, leverage, growth and age of firms. The panel regression is estimated based on the Generalized Method of Moment (GMM), an estimator that is widely used to control for endogeneity (see for an example; Haron, 2017)[87]. The panel regression model is explained as following:

$$Perf_{it} = \beta_0 Perf_{it(-1)} + \beta_1 Mly_{it} + \beta_2 Dir_{it} + \beta_3 IndBrd_{it} + \beta_4 CEOD_{it} + \beta_5 Rem_{it} + \beta_6 ConOwn_{it} + \sum Controlled_{it} + \varepsilon_{it}$$

[85] N. A. Sheikh, Z. Wang and S. Khan, "The Impact of Internal Attributes of Corporate Governance on Firm Performance: Evidence from Pakistan", op. cit.

[86] E. Lehmann and J. Weigand, "Does Governed Corporation Perform Better? Governance Structures and Corporate Performance in Germany", *European Finance Review*, 4(1), (2000), 157-195.

[87] R. Haron, "Ownership Structure of Family-Owned Firms and Debt Financing. Evidence on *Shari'ah*-Compliant firms in Malaysia", *Al-Shajarah* (Special Issue in Islamic Banking and Finance), (2017), 139-163.

Where, $Perf_{it}$ (Firm Performance) is represented by the ratio of Net profit over Total Shareholders Equities, Mly_{it} (Muslim Directors) the ratio of Muslim Directors over Total Directors on Board, Dir_{it} (Number of Directors on Board) in log10, $IndBrd_{it}$ (Independent Board Member) the ratio of independent board member over total board member, $CEOD_{it}$ (CEO Duality) represented by 1 if CEO is also the Chairman of the Board, 0 otherwise, Rem_{it} (Executive and Non-Executive Board Remuneration in Ringgit) in log10 and $ConOwn_{it}$ (Ownership Concentration) measured based on the shareholdings of 5 percent and above. $Controlled_{it}$ (Controlled variables) are Firm Size (total asset in log10), Leverage (ratio of total debt over total asset), Growth (ratio of market value of equities over book value of equities) and Firm Age (years since incorporated in log10), while ε_{it} is the error term.

5.0 Results Analysis and Discussion.

5.1 Descriptive Statistics

Table 1.

Variable	Mean	Median	Maximum	Minimum	Std. Dev.
Firm Performance	0.0483	0.0639	68.9391	-27.4946	1.0523
Muslim Directors	0.3469	0.2857	2.0000	0.0000	0.2606
Board of Directors	0.8655	0.8451	1.3424	0.3010	0.1118
Independent Board	0.4273	0.4000	2.0000	0.0000	0.1387
CEO Duality	0.2239	0.0000	1.0000	0.0000	0.4168
Remuneration	6.1483	6.1483	8.2388	3.1714	0.4492
Ownership Concentration	0.4774	0.4986	0.9993	0.0000	0.1928
Size	5.5492	5.4618	8.0686	0.0000	0.6200
Leverage	0.2189	0.1835	11.5259	0.0000	0.3016
Growth	1.2124	0.8031	157.3917	-240.2468	3.8605
Age	1.3207	1.3617	2.0414	0.0000	0.3287

5.2 Regression Results

With regard to Table 2, almost all corporate governance mechanisms incorporated in this study reveal a significant relationship with the performance of firms in Malaysia during the period understudy. The Muslim director is found to be positively related with firm performance thus supporting H_1. This positive relationship is in line with what researchers like Ahmad (2001)[88] and Volonte (2015)[89] have proposed that the humans' ethical value guided by *Shari'ah* principles encourages good corporate governance mechanism and may reduce monitoring cost and will focus on improving firm performance rather than accumulating wealth at the expense of other shareholders. Board size also shows positive relationship with firm performance thus H_2 is also supported. This finding lends support for Sun *et al*. (2014)[90] and Chugh *et al*. (2011)[91] that large board can increase monitoring and offer collective advice to the CEO based on better pooled resources from different board members thus increase firm performance and firms in Malaysia seems to hold to this argument.

Table 2.

Variable	Coefficient	t-Statistic	Prob.	VIF
Firm Performance (-1)	-0.0299	-4.7599	0.0000	
Muslim Directors	1.4875	8.6908	0.0000	1.14
Board of Directors	2.9535	7.6251	0.0000	1.34
Independent Board	0.6900	4.4133	0.0000	1.18
CEO Duality	0.1097	2.7069	0.0068	1.02
Remuneration	-0.0540	-1.6695	0.0951	1.49
Ownership Concentration	0.0128	0.2080	0.8352	1.06
Controlled Variables				
Size	-0.3429	-4.0722	0.0000	1.59
Leverage	0.0047	0.1261	0.8997	1.03
Growth	-0.1464	-9.1237	0.0000	1.01

[88] M. S. Ahmad, "Work Ethics: An Islamic Prospective", op. cit.
[89] C. Volonte, "Culture and Corporate Governance: The Influence of Language and Religion in Switzerland", op. cit.
[90] J. Sun, G. Lan and G. Liu, "Independent Audit Committee Characteristics and Real Earnings Management", op. cit.
[91] L. C. Chugh, J. W. Meador and A. S. Kumar, "Corporate Governance and Firm Performance: Evidence from India", op. cit.

Age	0.1880	1.7287	0.0839	1.08
AR(1) *m*-statistic	-1.7263		0.0843	
AR(2) *m*-statistic	-1.5138		0.1301	
J-statistic	74.8256		0.1272	

Notes: The t-statistics are the t-values adjusted for White's heteroscedasticity consistent standard errors. The m-statistic for AR(2) refers to the null of no second order correlation in the residuals; the J-statistic for the null that the over identifying restrictions are valid. The VIF test of less than 10 confirms that there is no multicolinearity problem in the dataset.

Director remuneration however is negatively related with firm performance in Malaysia during the period understudy, thus H_3 is rejected. It seems that the BoD in Malaysia do not generally hold on to handsome remuneration as motivation to increase firm performance. This negative relationship also demonstrates what Hassan and Theo (2003)[92] has argued that remuneration is less effective to improve firm performance among family owned firm because of conflict of interest that exists between majority and minority shareholders. Most of the firms in Malaysia are family owned and this supports the argument made by Hassan and Theo (2003)[93] thus justifies the negative relationship.

Looking at board independence, a positive relationship is depicted in this study, thus supporting the H_4. This finding supports O'Connell and Cramer (2010)[94] whom record a positive relationship as well. As explained by Jensen and Meckeling (1976)[95], a higher proportion of independent directors is expected to provide effective monitoring of the management, and thereby improve firm performance. The same goes to CEO duality which presents a positive relationship as well. Nevertheless, H_5 is rejected. CEO duality ensures concentrated power in one hand to avoid conflicts of interest when monitoring and advising manager in making important decision to enhance firm performance, thus justifies the positive

[92] S. Hassan and C. Theo, "Directors' Remuneration and Firm Performance: Malaysian Evidence." Malaysian Accounting Review, 2(1), (2003), 57-67.
[93] Ibid.
[94] V. O'Connell and N. Cramer, "The Relationship between Firm Performance and Board Characteristics in Ireland", op. cit.
[95] M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure", op. cit.

relationship depicted in this study. This finding is consistent with studies such as Sanda *et al*. (2005)[96] and Ramdani and Witteloostuijn (2010)[97]. However, this positive relationship does not seem to agree with the positive relationship depicted between independence board and firm performance.

Other controlled firm level determinants seem to show significant influences on firm performance as well as documented in the existing body of knowledge, with exception on leverage. Firm size and growth show a negative relationship while age of firms positively related with firm performance. Nevertheless, this study does not seem to provide evidence of the influence of ownership concentration on the performance of firms in Malaysia during the period understudy.

6.0 Conclusion

This study aims at examining several corporate governance mechanisms that are identified as having substantial influence on the performance of firms in the literature. Using the GMM to analyse 743 publicly listed firms in Malaysia over the period of 16 years from 2000 to 2015, this study incorporates corporate governance mechanisms like Muslim director, CEO duality, board independence, ownership concentration, board size and directors' remuneration on firm performance while controlling for some firm level determinants that include firm size, leverage, growth and age of firms. This study also addresses the issue of endogeneity by using the GMM which is often ignored in most previous studies.

The findings from this study reveal that the presence of Muslim directors in the BoD does have significant impact on the performance of firms in Malaysia. Firm performance increases with the presence of Muslim directors as Muslim directors are expected to perform their duty and task with full ethical values expected of them.

[96] A. U. Sanda, A. S. Mikailu and T. Garba "Corporate Governance Mechanisms and Firm Financial Performance in Nigeria", op. cit.

[97] D. Ramdani and A. V. Witteloostuijn, "The Impact of Board Independence and CEO Duality on Firm Performance: a Quantile Regression Analysis for Indonesia, Malaysia, South Korea and Thailand", *British Journal of Management*, 21(3), (2010), 607-627.

They should adhere to the *Shari'ah* principles in pursuing maximum performance without accumulating wealth out of their own interest at the expense of other shareholders. This is quite expected as Muslim is the biggest population in Malaysia. Interestingly, this notion is enhanced by the negative relationship reveals between director remuneration and firm performance. Perhaps, having Muslim directors in the BoD manifests the ethical values attached to them as these directors do not see attractive incentive in terms of high remuneration as catalyst and motivator to bring the firm to its utmost performance.

BoD in Malaysian firms still considers board independence in their board composition as board independence offers sound advice and resources in order for the BoD to advise the managers in executing their task in bringing the firm to the best of performance. This is where board size comes in in this study where the larger the size of the board the more outside directors are expected to share values, resources and experience in the operation of the firms to achieve maximum firm value. However, the concept of CEO duality does not seem to correspond with the concept of board independence practiced. Firms in Malaysia seems to agree with board independence yet still support CEO duality, having the same Chairman and CEO at the same time as to minimise monitoring cost and to avoid conflict of interests between two different people in charge. This perhaps demands for a more in depth and exclusive investigation in the future. Nevertheless, ownership concentration does not seem to provide any significant evidence in this study thus is unable to confirm to what has been reported in the literature.

Three of the controlled firm level determinants also seem to adhere to what has been documented in the literature. Firm size and growth show a negative relationship while age of firms positively related with firm performance. However, leverage appears to be insignificant.

This study hence offers some policy implications. Policy makers regulators and other players should not neglect the significant influence of having Muslim directors in the BoD as it is evidenced here that Muslim directors can bring the firm to its utmost performance. Director remuneration does not necessarily motivate

BoD to perform to its best. It could be a good catalyst to some but not all BoD perhaps. The fact that board independence and CEO duality can coincide and may not be agreeable with each other, corporate governance policy makers should carefully devise an appropriate corporate governance structure to suit their own firm individually to achieve maximum firm value. Responsible players should not neglect the impact of these corporate governance mechanisms on firm performance especially in Malaysia where diversity is very much enhanced in terms of race, ethnic, religion and culture. This study uses a wide span of study period and a substantial number of firms in its investigation, thus is relatively fit for generalization and perhaps can be extended to other emerging markets as well.

However, this study does have some limitations. There are other corporate governance mechanisms that do have important influence on firm performance that are not included in this study like gender diversity, directors' qualifications, directors' age and so forth. Perhaps future research can incorporate these elements in their examination of corporate governance thus enrich the literature further.

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