

# MCCG 2007 revolution: a dynamic analysis of the independent directors towards a Malaysian public listed company's performance

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## Keywords

Shariah Compliant, Dividend Yield, MCCG, Corporate Governance and Independent directors.

## Abstract

*The main purpose of this study is to examine the effects of implementation of Malaysian Code of Corporate Governance (MCCG) 2007 towards a public listed company's performance in relation to a Shariah or non-Shariah compliant. The MCCG had become indispensable part of the Bursa Malaysia Listing Rules, which requires all listed companies to disclose the extent of compliance with it. The amended code of Corporate Governance emphasized several significant changes on the earlier code of MCCG 2000 which is made vital to safeguard the interests of all investors without violating the principles of Shariah. The study focuses on the 37 Malaysian PLCs excluding financial institutions for the period of 2000 to 2010. Statistical tests of Newey West T-Test and the  $R^2$  were used to determine whether there was enough evidence to reject a null hypothesis about the processes. The findings suggest that there is a significant relationship between governance attributes and financial performance in effect of the implementation of MCCG 2007 towards Shariah compliant company's performance measured by dividend yield (DY). Comparatively, it was also found out that there is a significant inverse relationship between the number of independent directors towards a non-Shariah compliant company's performance measured by earnings per share (EPS). This relationship denotes a 1% significant level which testifies that changes in the number of independent directors may influence the company's EPS oppositely. The study also highlighted the importance for Malaysian PLCs to continuously practice good corporate governance regardless of Shariah compliant as it ensures the shareholders and potential investors a safety investment through the presence of independent directors.*

## 1.0 Introduction

The financial scandals in the United States of America (USA) have been considered as a wake-up call for the need of better corporate governance and transparency among Malaysian companies. As a matter of fact, some of the reasons for high profile corporate failures are those that lack of vigilant oversight functions by the board of directors, the board relinquishing control to corporate managers who pursue their own self-interests and the negligence of the board in its accountability to the stakeholders (Abidin, Kamal and Jusoff, 2009). Accordingly, the Malaysian Code on Corporate Governance (MCCG) had been established by the Working Group on Best Practices in Corporate Governance (JPK1) to serve as guidelines to the board of directors on how to manage the company based on their roles and responsibilities (p. 438). The code was subsequently approved by the High Level of Finance Committee on Corporate Governance in providing relevant information to the investors to enable them to guide the company's direction (Low, 2000). This, had therefore, resulted in a requirement for companies in Malaysia to apply the broad principles of good corporate governance as set out by the code flexibly and with common sense to the varying circumstances of individual companies.

While subsequent to the establishment of Malaysian Codes of Corporate Governance (MCCG) in 2000, a revised edition was issued in the year 2007 which addressed the lacking elements of the earlier code. Notably, the underlying principles of the codes focus on four areas including the board of directors, director's remuneration, shareholders and accountability and audit (Zulkafli, et al., 2000). The researchers imply that the code is a hybrid in nature, in which the underlying principles of these codes are largely derived from the recommendations of the Cadbury Report (1992) and the Hampel Report (1998) in the United Kingdom. Thus, its pertinence to Malaysian companies provides guidelines on the principles of best practices on structures and processes that companies may use in their operations towards achieving

the optimal governance framework. These structures and processes exist at a micro-level which include issues such as the composition of the board, procedures for recruiting new directors, remuneration of directors, the use of board committees, their mandates and activities.

The fact that corporate governance significantly influence a company's performance can be seen when researchers indicate for significant positive correlations between good governance and the organizations' financial performance (Liang Li, 1999; Williams, 2000; Alves and Mendes, 2002; Drobtz, Schillhofer and Zimmerman, 2003; Gemmill and Thomas, 2004; Brown and Caylor, 2004; Garay and Gonzalez, 2008; Selvaggi and Upton, 2008; Martani and Saputra, 2009). As a matter of fact, the positive correlations as well do not differ from those companies with Shariah or non-Shariah compliant. In Malaysia, the Shariah Advisory Council was established in 1996 to advise Securities Commission on Shariah related matter. This includes providing guidance on Islamic Capital Market (ICM) transactions and activities in ways that do not contrary the principles of Islam.

In addition to this, a company that practices good corporate governance is also able to improve its investor confidence which in return resulted in better financial disclosures and more transparent business reporting (Graham, Litan and Sukhtankar, 2002). Not to mention, prior study by Shleifer and Vishny (1997) stated that, another reason contributing to the positive effects of having good corporate governance is because, it assures investors in corporations that they will receive adequate returns on their investments. This is especially important as Che Haat, Abdul Rahman, and Mahenthiran (2008) emphasize the consequence of the non-existence of good corporate governance or improper function of the mechanism may result the outside investors for not willing to lend the firms or buy their equity securities. Thus, leading the likelihood for the economic performance to suffer as many good business opportunities would be missed and temporary financial problems at individual firms would spread quickly to other firms, employees and consumers.

Realizing the weightiness of adherence to the codes, this study aims to achieve the following objectives: firstly, to evaluate the necessary existence and contributions of independent directors to performance of the Malaysian Public Listed Companies, secondly, to investigate the interaction effects after the implementation of MCCG 2007 towards Shariah and non-Shariah compliance of Listed Companies' performance, and finally, to contribute to the ongoing debate on corporate governance relating the roles of independent directors in a Malaysian context. For this reason, a balanced panel data approach of 30 listed Shariah compliant companies and 7 listed non-Shariah compliant companies were employed over a period of eleven years starting from 2000 to 2010. The remainder of this study is organized as follows. The second section provides a brief review to the related literature and the research hypotheses development. The third section presents the sample selection procedures and methodology used. The fourth section shows the data analysis and empirical results as well as conclusion for the study.

## 2.0 Literature Review

With attention to the corporate scandals that have emerged in recent years, studies of the independent directors have increased in importance in respect to their roles towards the company's performance (Stein and Plaza, 2011; Shukeri, Ong, and Shaari, 2012). Not to mention researchers have claimed that these scandals had been related to conflicts of interest between the companies' managers and their shareholders. Thus, within this context and from the perspective of agency theory, the independent director has been highlighted as a basic governing instrument for neutralising problems between the principal (shareholders) and the agent (managers). Additionally, Fama (1980) stated that the inclusion of independent directors may help to reduce the probability for collusion and expropriation by top management on the shareholder's wealth, as they were claimed the professional referees to assist the shareholders in overseeing and monitoring the company's management. Together with their pivotal role in a stewardship and strategy formulation of the company, Bose (2009) supported that they were also seen as trustees and best guarantor of good corporate governance as they do not collude with the management; rather, facilitate the governance functions of the board as a whole (Dechow, Sloan and Sweeney, 1995; Klein, 2002; Xie, Davidson and DaDalt, 2003; Peasnell, Pope and Young 2005).

Parallel to the existing empirical evidences as well, many researchers have agreed with the association between non-executive directors with stronger corporate governance and integrity in financial

reporting as a result of their interference in decision making (Rosenstein and Wyatt, 1990; Dechow et al. 1996; Beasley 1996; Core, Holthausen and Larcker, 1999). In the light of the positive reason for their inclusion, a requirement by the Malaysian Code of Corporate Governance (MCCG, 2000; 2007) to have at least one-third of the board members are independent directors had been made vital to ensure a proper conduct by the board of directors towards the company's operation and their accountability to the shareholders. In essence to this, it is stipulated as follows:

"Every listed company should have independent directors, that is directors that are not officers of the company; who are neither related to its officers nor represent concentrated or family holdings of its shares; who, in the view of the company's board of directors, represents the interest of the public shareholders, and are free of any relationships that would interfere with the exercise of independent judgment". (Finance Committee on Corporate Governance, paragraph 4.23, p.82)

In a like manner, their proportion as part of the board membership had been known to have negatively associated with financial distress (Abdullah, 2006; Li, Zong-jun, and Deng, 2008) whereby a company with a higher proportion of the independent directors resulted in a lower administrative expense ratio which is a measure of managerial agency costs that reflects the probability of financial distress. This is followed by the reasons justifying that their existence as apart from correcting any possible conflicts of interest and safeguarding the shareholders wealth in a company, thereupon, serve as a function to improvise the quality of the company's governance and ensuring effective supervision of the executive team (Stein and Plaza, 2011). As has been noted, only a person who is completely dissociated from the management team can provide effective supervision as such.

## 2.1 The Agency Cost Theory

According to Jensen and Meckling (1976), agency theory is defined as the relationship between two parties in which management is seen as agents and the owner as the principals of an organization. Notably, the managers have been appointed as directors (insiders) of the firms due to their advantages of having more information about the organization than the outside directors (Beasley, 1996). In view of this, the Malaysian Code of Corporate Governance indicated that the board of directors as one of the effective mechanisms to control for any potential conflicts of interests between the owners and managers and reduce agency costs. Not to mention the board of directors has been considered as the strongest internal monitor of the top management as they have the power to hire, lay-off, and compensate the top management (Fama and Jensen, 1983).

The domination by insiders, however, has led to the expropriation of wealth, due to managers' tendency to prioritize their own interest at the expense of the shareholders (Berle and Means, 1932; Beasley, 1996). The inconsistent interests, as such, between the management and shareholders are reasons for the occurrence of agency costs (Agrawal and Knoeber, 1996), which leads to the separation of ownership and control (Berle and Means, 1932; Hermalin and Weisbach, 2003). As a matter of fact, Easterbrook (1984) clarified that managers may not necessarily act upon the shareholders' maximization wealth. This can be seen as when the company's levels of retained earnings are high, managers are expected to channel the availability of funds into inappropriate projects either for their own benefits or due to the managers' incompetency, which therefore, exposing the shareholders to unnecessary investment risk. Likewise, studies based on the management entrenchment hypothesis also indicate that, managers will pursue a project for their own self-interest, whenever the firm risk is higher and will try to manipulate earnings in order to avoid investors' concerns (DeAngelo and Rice, 1983; Stein 1988).

Another reason that gives rise to a conflict of interest among the managers is due to the fact that shareholders are lacking the information about the company and the behaviour of its managers (Al-Najjar and Hussainey, 2009). In accordance to this, a suggestion for the control of agency problems is made vital which decide for the inclusion of independent directors to be significant as they play a major role in protecting the shareholders' wealth especially in the absence of large shareholders who can directly monitor management through regular engagements with management of companies and vote on key issues at general meetings (Johanson and Ostergren, 2010).

### 2.3 The Financial Indicators of EPS and DY on Corporate Performances

As for this study, the two distinctive variables used to assess a company's performance in relation to the existence of independent non-executive directors in Malaysian public listed companies were earnings per share (EPS) and dividend yield (DY). Theoretically, the EPS ratio is the most commonly used ratio to measure a company's performance. It is the net income generated by the company to the weighted average of the total number of shares. In particular for the use of EPS as the company's financial performance indicator, a GAAP (Generally Accepted Accounting Practices) definition is stated as follows: EPS give investors a means of determining the amount that the business earned on its stock share investments. In another word, it tells investors how much net income the business earns for each stock share they owned (p.1).

Parallel to the definition as well, a statement by IAS 33 (International Accounting Standard) that emphasized the used of the variable as to assess the ongoing financial performance of a company from year to year, and to compute the major stock market indicator of performance, the price-earnings ratio. While, this ratio provides an important reason for the net income to be communicated to the stockholders on a per share basis, it has not only enabled them to compare it with the market price of their shares but also allows other users of the financial statements to compare performance between different companies in the same reporting period and between different reporting periods for the same company. Accordingly, Laksono (2011) stated that, the shareholders and potential investors had been widely use earnings per share in evaluating the profitability of a company in which the ratio indicates the income earned from each ordinary share. He illustrated that the EPS information is generally reported below the net income; and a company is obligated to report EPS and net income from continuing operations especially for the income statement that contains discontinued operations.

Meanwhile, as for the dividend yield, it signifies the investors about how much they can earn for each Ringgit invested in a stock or how much a company pays out in dividends relative to its share price for each year. Lee (2009) extends the meaning of the ratio as investors earn returns from their shares in the form of capital gains and dividend yield. However, he regarded dividend yield as an important ratio in evaluating investments, as in the absence of any capital gains, the dividend yield represents the return on investment for a stock. As a matter of fact, the ratio is positively related to stock prices, and it was claimed by researchers that, it provides signal about the future prospects of the company which is the reason of investors want dividends (Khan et al., 2011). Apart from that, dividend yield is also seen as the 'only offer of a decent income for investors especially when yields on bonds decreases during the 'bear market' coupled with the prevailing low interest rates. For this reason, investors may decide to purchase or continue to hold stock of a company that is offering a more predictable return of which is a continuous dividend. Unlike EPS, researchers have claimed that there have been limited studies using dividend yield as a direct measure for a company's performance. However, this does not overwhelm the purpose of the study, as vast literatures indicating a significant relationship of dividend yield towards agency costs issues (Brunarski, Harman, and Kehr, 2004). In regards to this, it indirectly forms an opportunity for researcher to investigate its correlation towards performances as in relation to the explanatory variables of the study.

### 2.4 Control Variables and Companies' Performances

To better examine the effects of independent non-executive directors and managerial ownership on firm performance, the study used control variables namely, firm size, firm age and financial leverage of debt-equity ratio that may affect companies' performances.

#### 2.4.1 Firm size

Company size is often referred to as market capitalization, which is the value of a company on the open market. Some researchers indicated market capitalization as a measure of firm size due to the fact that large firms will pay large dividends to reduce agency costs (Eddy and Seifert, 1988); Redding, 1997). In relation to this, the free cash flow and life-cycle hypotheses posit that larger firm tends to be more mature and have higher free cash flows than smaller firms, thus, they are more likely to pay higher dividends (Taleb, 2012).

### 2.4.2 Firm Age

Firm age also appears as a control variable in various empirical finance studies. Not only it is a control variable in default forecast models (Shumway, 2001) and in takeover prediction models (Bhattacharjee, Higson, Holly, and Kattuman, 2009), but also, it is used to measure increasing complexity of operations (Coles, Daniel, and Naveen, 2008). Shumway (2001) claimed that the economically most meaningful measure of firm age is the number of years since listing. This is because the researcher believed that it is a defining moment in a company's life. However, a study by Loderer and Waelchli (2010) on the relationship between firm age and profitability found out that there is no distinct difference between firm age measured since listing and incorporation age. The researchers indicate that both findings generally the same and decided to define firm age as the number of years since listing due to the availability of data for the full sample of firms. Additionally, in order to distinguish between cohort and true aging effects, the researchers estimate the relation between firm age and profitability using robust panel regressions. This is due to reason as cross sectional OLS regressions are unable to make that distinction, which could explain why, in some cases, OLS regressions find no relation between firm age and profitability (Villalonga and Amit, 2006). In relation to the age of a firm, James and Wier (1990) proclaim that investors' uncertainty lessens as the firm grows older. This is followed by Loderer and Waelchli (2010) as they asserted that corporate aging is distinct from factors such as concave investment opportunity sets, uncertainty, ownership structure, age of officers and directors, and industry age. In a different study by Anderson and Reeb (2003), the researchers found out that the log of firm age (measured since inception) in family firms are negatively related to profitability.

### 2.4.3 Financial Leverage (Debt-equity Ratio)

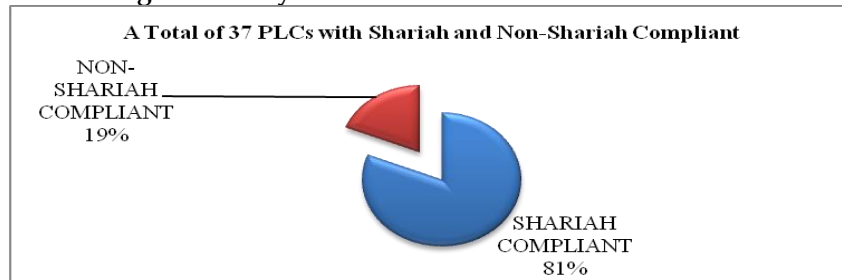
Debt-to-equity ratio has been used as a proxy by the existing studies such as Jensen, Solberg and Zorn (1992) as well as Taleb (2012). Debt-equity choice is one of the most important decisions in financing policy. The impact of a faulty financing decision on a company could be disastrous as was experienced by many South East Asian companies in the 1997 financial crisis. Accordingly, this ratio indicates how firms choose to finance operations. A high debt-equity ratio generally means that a company has been aggressive in financing its growth with debt. Agency theory foresees that the board's effectiveness would grow as the extent of leverage rises which in return would increase the firm's performance. This is due to reason as debt financing raises the pressure of managers to perform (meaning to reduce their waste of resources and to increase their effort) as it reduces "free cash-flow" at the disposal of managers (Jensen, 1986). Indeed, debt implies interest payment obligations that must be satisfied by managers, under the threat of a bankruptcy if these obligations are not satisfied. Grossman and Hart (1982) also argue that debt financing provides better incentives for managers to perform as they aim to avoid the personal costs of bankruptcy. Consequently there should be a positive influence of leverage on corporate performance. However, the cost of this debt financing may outweigh the return that the company generates on the debt through investment and business activities and become too much for the company to handle. This can lead to bankruptcy, which would leave shareholders with nothing.

## 3.0 Data and Methodology

This study focuses on the Malaysian public listed companies for the period of 2000 to 2010 (11 years) and extensively uses secondary data from various sources which include the company's annual reports, newspapers, past researches, journals, articles, books and working papers. A number of samples have been gathered and determined based on a census study where the filtration process is necessarily to ensure the sample size fairly consistent. For this reason, it may have to take into account of the company's characteristics in terms of a continuous operation for 11 years period and the fact that only non-financial institutions (excluding merged and unit trust companies) are accepted as the sample of the study. This is due to reasons that those institutions may be subject to different regulatory framework, which does not apply to other public listed companies (Yatim et al., 2006; Mat Nor and Sulong, 2007; Ponnu, 2008). Apart from that, a selection of publicly listed company may depend on companies who have been paying a dividend consecutively for the past 11 years due to the choice of dividend yield ratio as a financial indicator for company's performance.

In particular to this, the filtration process for a number of 957 populations of Malaysian Public Listed Companies (as per date March 20, 2012) undertook two steps, whereby, first is to exclude a list of publicly listed companies in the financial industry as well as merged companies and second is by means of a consecutive dividend payment throughout the time frame and based on the availability of the annual report. To enumerate, a number of 37 Malaysian public listed companies is determined and the list is segregated according to Shariah and non-Shariah compliance of listed companies. Notably, a Shariah compliant companies are companies that conduct activities (company's core businesses does not relate to any of the following categories: (1) alcohol; (2) tobacco; (3) pork products; (4) conventional financial services (banking, insurance, etc.); (5) defense/weapons; and (6) entertainment (hotels, casinos/gambling, cinema, pornography, music, and more) which are not contrary to the Islamic principles and have been approved and classified as Shariah compliant companies by the Shariah Advisory Council (Othman, Thani and Ghani (2009). As shown in Figure 1, the sample of the study consisted of a majority companies (30-listed companies) from different sectors/industries are complied with the Shariah principles. This is represented by 81% of a total sample size of 37 Malaysian PLCs. Meanwhile, 19% of them comprised of listed companies with non-Shariah compliant.

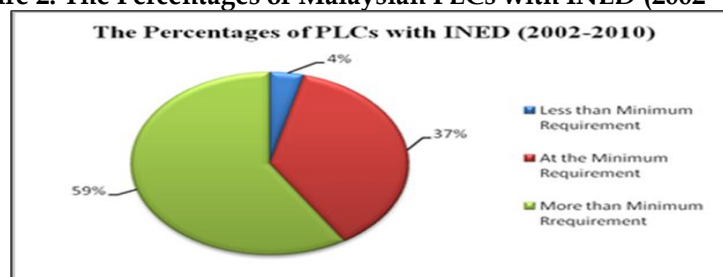
**Figure 1: Percentages of Malaysian PLCs with Shariah and non-Shariah Compliance**



The following statistic depicted a number of Malaysian public listed companies with independent directors that had less than the minimum requirement, at a minimum requirement as well as those with a majority of independent directors (having a number of independent directors more than the minimum requirement) as shown in Figure 2. The year 2002 was chosen for the purpose of observing the effect of the newly revamped Kuala Lumpur Stock Exchange (KLSE) Listing Requirements on corporate governance which was introduced in 2001. The new listing requirements required all listed companies to include in their annual reports a separate statement on corporate governance (Che Haat, Abdul Rahman, and Mahenthiran, 2008).

As can be seen in the pie-chart below, a majority of 59% of the sample size had more independent non-executive directors than required, while 37% of them had independent directors at the minimum requirement of at least one-third or two persons of the BOD membership. Hence, only 4% of the Malaysian public listed companies had less than the minimum requirement. Thus, it can be generalized that most of the Malaysian public listed companies had a majority of independent non-executive directors, and there were a remarkably few listed companies within the period that had lesser than the minimum requirement (at least 1/3 or 2 persons of the BOD members, whichever is higher) of independent non-executive directors. This was obvious for the year 2002 (with 5 companies) due to the earlier introduction of the newly revamped KLSE Listing Requirements on corporate governance.

**Figure 2: The Percentages of Malaysian PLCs with INED (2002 - 2010)**



### 3.1 The Empirical Models

The empirical models for panel data technique are shown in equations 1 and 2 which were the earnings per share and dividend yield based on firm to firm framework.

Model 1

$$\ln EPS_{it} = \alpha + \beta_1 X_{1it} + \beta_2 \ln X_{2it} + \beta_3 \ln X_{3it} + \beta_4 \ln X_{4it} + \beta_5 \ln X_{5it} + \epsilon_{it} \dots (1)$$

Model 2

$$\ln DY_{it} = \alpha + \beta_1 X_{1it} + \beta_2 \ln X_{2it} + \beta_3 \ln X_{3it} + \beta_4 \ln X_{4it} + \beta_5 \ln X_{5it} + \epsilon_{it} \dots (2)$$

Where,	$\ln EPS_{it}$	=	Natural logarithm of Earnings per share for the period of time, $t$
	$\ln DY_{it}$	=	Natural logarithm of Dividend yield for the period of time, $t$
	$X_1$	=	Number of independent non-executive directors on the board for the period of time, $t$
	$\ln X_2$	=	Natural logarithm of Directors' Remuneration for the period of time, $t$
	$\ln X_3$	=	Natural logarithm of firm size for the period of time, $t$
	$\ln X_4$	=	Natural logarithm of firm age for the period of time, $t$
	$\ln X_5$	=	Natural logarithm of leverage (debt-equity ratio) for the period of time, $t$
	$\alpha$	=	Constant (alpha)
	$\beta$	=	$\beta_1, \beta_2, \beta_3, \beta_4$ and $\beta_5$ are the regression coefficient of variable (beta)
	$\epsilon_{it}$	=	Error term or residual for the period of time, $t$

### 3.2 Measurement of Independent and Dependent Variables

The independent variables included the number of independent non-executive directors in each company and the director's remuneration. There were no specific measurements of these variables, thus it was apt only to define the number of independent directors as set out in the Listing Requirement of Bursa Malaysia as well as the MCCG requirements whereby there should be at least 1/3 or 2 persons (whichever is higher) of the Board of Directors' members were independent non-executive directors. Meanwhile, the directors' remuneration as defined under Chapter 9 Appendix 9C, Part A of the Bursa's Listing Requirement specifies the aggregate remuneration of directors with categorization into appropriate components as such the directors' fees, salaries, percentages, bonuses, commission, compensation for loss of office, and benefits-in-kind based on the estimated monetary value of which all of these distinguish between executive and non-executive directors. The stock options in this regard is excluded due to the unavailability of data in Malaysian public listed companies (Conyon, Peck, and Sadler, 2000); however, as far as the purpose of this study and similar studies are concerned, the availability of the data was meant to be excluded from any possible compensation of independent directors as they could jeopardize their effective independence.

As for the dependent variables, the EPS ratio is calculated by subtracting the dividends paid to holders of preferred stock from the net income and dividing that result by the average number of common shares outstanding of the period. The earnings per share in this study are referred to the basic EPS as reported in the financial statement of a company (Hutchinson, 2004). Meanwhile, the dividend yield is a company's total annual dividend divided by its market capitalization; it is used to calculate the earnings on investment (shares) considering only the returns in the form of total dividends declared by the company during the year.

The control variables of the study were held constant to test the relative impact of independent variables towards dependent variables. In relation to the employment of these variables, previous study evidenced their effects as control factors as they influence the independent variable of corporate governance being tested, thus, affecting the outcome of the research which is the performances of companies in Vietnam measured by Return on Assets (ROA) (Vo and Phan, 2013). Straightaway, firm age is measured as number of years from the establishment of company or date of incorporation to research period (until 2010). Thereby, it was found out in this sample that the oldest a firm can be is 38 years since its establishment in 1973.

Meanwhile, this study had decided to use the natural logarithm of market capitalization as proxy for the size of a firm due to the fact that large firms will pay large dividends to reduce agency costs (Taleb, 2012). Market capitalization, sometimes called “market cap” refers to the value of a company's outstanding shares. As shown in equation 3, the market capitalization is calculated by multiplying current stock price with the number of ordinary shares in issue. In this regards, it is important to note that the market capitalization for this meaning is not the same as equity value, nor is it equal to a company's debt plus its shareholders' equity (although that is sometimes referred to as simply the company's capitalization), but denotes the theoretical cost of buying all of a company's shares (Yasmin and Yusuf, 2008).

Lastly, the financial leverage of debt-equity ratio is calculated by dividing total liabilities with stockholders' equity as seen in equation 4. This indicates a proportion of equity and debt that a company is using to finance its assets. A high debt-equity ratio generally means that a company has been aggressively financing its growth with debt. This can result in volatile earnings as in effect of the additional interest expense. Consequently, the cost of debt financing may outweigh the return that a company generates from its investment and/or business operating activities which potentially can lead to bankruptcy.

Market Capitalization

$$MK = \text{Share Price} \times \text{No. of ordinary shares outstanding} \dots (3)$$

Financial Leverage (Debt-equity Ratio)

$$DER = \frac{\text{Total Debt}}{\text{Total Equity}} \dots (4)$$

However, since the study control for these variables in all regressions, the researcher believed that this is not an important concern since they are held constant to test the relative impact of the independent variables towards companies' performances.

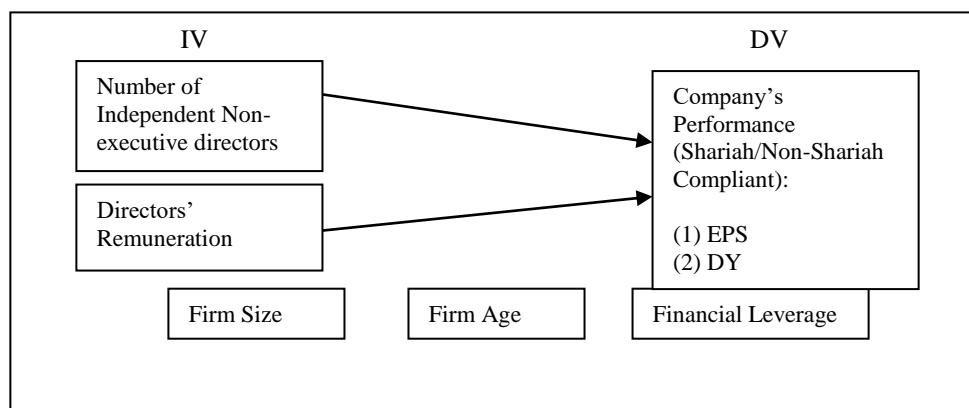
### 3.3 A Theoretical Framework

The influence of independent variables towards dependent variables can be reflected in a theoretical framework whereby the explanatory variables of the study consist of the number of independent directors and directors' remuneration, while, dependent variables encompasses the Malaysian Public Listed companies' performance measured by EPS and DY. Three (3) control factors firm size, firm age and leverage are included in the theoretical model of this study and were kept constant, so that the researcher can only measure the effects of concentration between the independent and dependent variables; thus, they needed to be controlled in this study.

### 3.4 Research Hypotheses

Figure 3 shows the relationship between independent and dependent variables of a company's performance measured by earnings per share and dividend yield distinguishing company of Shariah compliance and non-Shariah compliance. Table 1 indicated the hypotheses testing of the variables.

Figure 3: Schematic Diagram of the Theoretical Framework





**Table 1: The Hypotheses Testing**

<b>H1</b>	The relationship of independent directors' existence towards Shariah compliance of Listed Companies' performance (EPS)	<i>Ho</i> : There is no significant relationship of independent directors' existence towards Shariah compliance of Listed Companies' performance (EPS).	<i>Ha</i> : There is a significant relationship of independent directors' existence towards Shariah compliance of Listed Companies' performance (EPS).
<b>H2</b>	The relationship of independent directors' existence towards Shariah compliance of Listed Companies' performance (DY)	<i>Ho</i> : There is no relationship of independent directors' existence towards Shariah compliance of Listed Companies' performance (DY).	<i>Ha</i> : There is a significant relationship of independent directors' existence towards Shariah compliance of Listed Companies' performance (DY).
<b>H3</b>	The relationship of the implementation of MCCG 2007 towards Shariah compliance of Listed Companies' performance (EPS)	<i>Ho</i> : There is no significant relationship of the implementation of MCCG 2007 towards Shariah compliance of Listed Companies' performance (EPS).	<i>Ha</i> : There is a significant relationship of the implementation of MCCG 2007 towards Shariah compliance of Listed Companies' performance (EPS).
<b>H4</b>	The relationship of the implementation of MCCG 2007 towards Shariah compliance of Listed Companies' performance (DY)	<i>Ho</i> : There is no significant relationship of the implementation of MCCG 2007 towards Shariah compliance of Listed Companies' performance (DY).	<i>Ha</i> : There is a significant relationship of the implementation of MCCG 2007 towards Shariah compliance of Listed Companies' performance (DY).
<b>H5</b>	The relationship of independent directors' existence towards non-Shariah compliance of Listed Companies' performance (EPS)	<i>Ho</i> : There is no significant relationship of independent directors' existence towards non-Shariah compliance of Listed Companies' performance (EPS).	<i>Ha</i> : There is a significant relationship of independent directors' existence towards non-Shariah compliance of Listed Companies' performance (EPS).
<b>H6</b>	The relationship of independent directors' existence towards non-Shariah compliance of Listed Companies' performance (DY)	<i>Ho</i> : There is no significant relationship of independent directors' existence towards non-Shariah compliance of Listed Companies' performance (DY).	<i>Ha</i> : There is a significant relationship of independent directors' existence towards non-Shariah compliance of Listed Companies' performance (DY).
<b>H7</b>	The relationship of the implementation of MCCG 2007 towards non-Shariah compliance of Listed Companies' performance (EPS)	<i>Ho</i> : There is no significant relationship of the implementation of MCCG 2007 towards non-Shariah compliance of Listed Companies' performance (EPS).	<i>Ha</i> : There is a significant relationship of the implementation of MCCG 2007 towards non-Shariah compliance of Listed Companies' performance (EPS).
<b>H8</b>	The relationship of the implementation of MCCG 2007 towards non-Shariah compliance of Listed Companies' performance (DY)	<i>Ho</i> : There is no significant relationship of the implementation of MCCG 2007 towards non-Shariah compliance of Listed Companies' performance (DY).	<i>Ha</i> : There is a significant relationship of the implementation of MCCG 2007 towards non-Shariah compliance of Listed Companies' performance (DY).

#### 4.0 Analysis and Findings

The estimation technique for panel data involves a repeated observation on the dependent variables of DY and EPS for each 37 PLCs in relation to the elements of corporate governance and control variables for a period of 11 years. The analysis started by testing the stationarity of the data using Levin, Lin and Chu (LLC) and Im, Pesaran and Shin (IPS) tests. Thus, based on the panel unit root test, the results indicate that the variables are stationary and the null hypothesis is rejected at 1% significance level. As for the diagnostic testing, the results attested that the model regressions were strongly suffered from heteroscedasticity and some autocorrelation problems. This can be treated using the Newey West estimator to generate a robust standard error for a more reliable test statistic. On the other hand, the multicollinearity test shows the value of mean VIF are smaller than 10, therefore, all independent variables do not suffered from multicollinearity problem.

The analyses therefore, continued with the poolability test using Breusch and Pagan Lagrange Multiplier (LM) test, whereby, the findings of the results for Shariah Compliant based on the reformation of Corporate Governance can be seen in Table 2 and Table 3 presented the results for non-Shariah Compliant. Based on the findings in Table 2, it can be generally concluded that the model regression for dependent variable of lnDY is able to proceed for panel data estimators which evinced by the significant value of lesser than 1%. This indirectly indicates for the rejection of null hypothesis which stated variance across observation is constant (homoscedasticity). Meanwhile, the model regression for dependent variable of lnEPS (both reformation on corporate governance) has to be proceeded with simple OLS regression. In relation to the findings of panel data technique, it can be inferred that there is a significant relationship among the variables during the reformation of MCCG 2000. These relationships signified that the independent variables could have reliably predicted the dependent variable of lnDY as seen from the significant p-values. On the other hand, the findings of the results differ after the implementation of MCCG in 2007. This is obvious for most variables as they indicate for insignificant relationships (p-values of the t-statistics higher than 5% significant level). Meanwhile, the model regression for dependent variable of lnEPS based on OLS regression also suggest for insignificant relationship for both reformation of MCCG. This is evinced by the fact that the probability values of the F-statistic are greater than the significant level of 0.05 which leads to other information on the coefficient values and p-values of the t-statistics do not appear to be significant as well. Comparatively, the findings in Table 3 showed regression for dependent variable of lnDY after reformation of MCCG in 2007 is unable to precede for panel data estimators which indicate the used of the simple OLS regression. In relation to the findings of panel data technique, it can be deduced that there is a significant negative relationship between the independent variable of the number of independent directors towards the natural logarithm of EPS. This explained that as the number of independent directors increase by one, the natural logarithm of EPS is predicted to reduce by 0.11280 which is significant at 0.01 level. Meanwhile, other relationships do not appear to be significant after the implementation of MCCG in 2007 as seen from the p-values of the t-statistics higher than 5% significant level. The model regression for both dependent variables based on OLS regression indicates for the insignificant relationship of both reformation of MCCG due to the higher probability values of the F-statistic which is more than 0.05 significant levels.

**Table 2: Regression Results for Shariah Compliant based on the Reformation of Corporate Governance**

Statistic	During Reformation of MCCG2000 (2000 - 2006)		After Reformation of MCCG in 2007 (2007 - 2010)	
	lnEPS	lnDY	lnEPS	lnDY
Breusch Pagan LM Test	0.00	86.73	0.21	80.73
<b>p-value</b>	(1.0000)	(0.0001)***	(0.3216)	(0.0001)***

Hausman Specification Test	N/A	18.34 (0.0011)***	N/A	19.22 (0.0007)***
<b>FEM</b>	N/A		N/A	
<b>Infage</b>				
$\beta$		-0.66451		(Omitted)
t-stat		-2.30		
p-value		(0.023)**		
<b>Infsize</b>				
$\beta$		-0.61131		-0.75443
t-stat		-4.55		-5.61
p-value		(0.0001)***		(0.0001)***
<b>Inder</b>				
$\beta$		0.19648		0.04377
t-stat		1.77		0.20
p-value		(0.078)*		(0.841)
<b>ined</b>				
$\beta$		0.10136		0.06650
t-stat		2.38		0.73
p-value		(0.018)**		(0.465)
<b>Indremu</b>				
$\beta$		0.16318		0.04618
t-stat		2.03		0.40
p-value		(0.044)**		(0.688)
<b>Constant</b>				
$\beta$		13.01927		15.88709
t-stat		4.85		4.98
p-value of $\alpha$		(0.0001)***		(0.0001)***
<b>F-stat</b>		7.34		8.05
<b>Prob. F</b>		(0.0001)***		(0.0001)***
R-squared (within)		0.1734		0.2723
No. Obs		210		120
<b>OLS</b>				
<b>Infage</b>				
$\beta$	-0.05245		-1.83811	
t-stat	-0.57		-0.72	
p-value	(0.575)		(0.481)	
<b>Infsize</b>				
$\beta$	-0.00267		0.12271	
t-stat	-0.13		1.73	
p-value	(0.896)		(0.097)*	
<b>Inder</b>				
$\beta$	0.01147		-0.33424	
t-stat	0.71		-1.19	
p-value	(0.482)		(0.247)	
<b>ined</b>				
$\beta$	-0.00877		0.12825	
t-stat	-0.75		0.85	
p-value	(0.463)		(0.401)	
<b>Indremu</b>				
$\beta$	0.01329		0.40400	

t-stat	0.56	1.08
p-value	(0.578)	(0.272)
<b>Constant</b>		
$\beta$	1.90125	-3.51806
t-stat	6.87	-1.12
p-value of $\alpha$	(0.0001)***	(0.272)
<b>F-stat</b>	0.67	1.49
<b>Prob. F</b>	(0.6497)	(0.2289)
R-squared	0.07431	0.3716
No. Obs	30	30

Notes: \* denotes significance at the 10% level, \*\* denotes significance at the 5% level and \*\*\* denotes significance at the 1% level.

**Table 3: Regression Results for non-Shariah Compliant based on the Reformation of Corporate Governance**

Statistic	During Reformation of MCCG2000		After Reformation of MCCG in 2007	
	(2000 - 2006)		(2007 - 2010)	
Dependent Variables	lnEPS	lnDY	lnEPS	lnDY
Breusch Pagan LM Test				
<b>p-value</b>	0.00 (1.0000)	28.14 (0.0001)***	10.39 (0.0013)***	0.38 (0.2682)
Hausman Specification Test	N/A			N/A
<b>p-value</b>		0.75 (0.9456)	3.00 (0.5584)	
<b>MLE</b>	N/A			N/A
<b>Infage</b>				
$\beta$		-0.72031	-1.75477	
Z-stat		-0.09	-0.99	
p-value		(0.924)	(0.323)	
<b>lnfsize</b>				
$\beta$		-0.17025	0.05633	
Z-stat		-1.09	1.15	
p-value		(0.275)	(0.252)	
<b>lnder</b>				
$\beta$		0.29127	-0.03098	
Z-stat		2.62	-1.00	
p-value		(0.009)***	(0.315)	
<b>ined</b>				
$\beta$		0.10533	-0.11280	
Z-stat		1.13	-2.84	
p-value		(0.261)	(0.005)***	
<b>Indremu</b>				
$\beta$		-0.10264	0.02695	
Z-stat		-0.62	0.62	
p-value		(0.535)	(0.537)	
<b>Constant</b>				
$\beta$		8.49254	5.77277	
Z-stat		9.36	9.93	
p-value of $\alpha$		(0.720)	(0.302)	
<b>No. Obs</b>		49	28	
<b>OLS</b>				
<b>Infage</b>				

$\beta$	1.18349	-15.56423
t-stat	0.61	-5.99
p-value	(0.651)	(0.105)
<b>Infsize</b>		
$\beta$	-0.22302	0.73225
t-stat	-1.06	10.36
p-value	(0.480)	(0.061)*
<b>Inder</b>		
$\beta$	0.18635	-0.53168
t-stat	1.24	-8.15
p-value	(0.432)	(0.078)*
<b>ined</b>		
$\beta$	0.30991	-1.40329
t-stat	1.16	-7.93
p-value	(0.454)	(0.080)*
<b>Indremu</b>		
$\beta$	0.079941	0.15664
t-stat	0.83	2.03
p-value	(0.558)	(0.291)
<b>Constant</b>		
$\beta$	0.72019	36.50724
t-stat	0.17	4.85
p-value of $\alpha$	(0.893)	(0.129)
<b>F-stat</b>	0.71	42.73
<b>Prob. F</b>	(0.7115)	(0.1156)
R-squared	0.7562	0.9635
No. Obs	7	7

Notes: \* denotes significance at the 10% level, \*\* denotes significance at the 5% level and \*\*\* denotes significance at the 1% level.

As for the evaluation on the hypotheses testing of H1, H2, H3 and H4 for Shariah compliance, it can be generalized that there is a significant relationship of independent directors' existence towards Malaysian public listed companies' performance measured by dividend yield. This is implied by a significant level at 0.05 during the reformation of MCCG 2000, while, others attested for a failure to reject the null-hypotheses of the study. On the other hand, the hypotheses testing of H5, H6, H7 and H8 for non-Shariah compliance indicate that there is a significant relationship of the independent directors' existence towards companies' performance measured by earnings per share. This is obvious after the implementation of MCCG 2007 which is significant at 0.01 levels. Meanwhile, the hypotheses testing for H6 and H8 indicate for the failure to reject null hypotheses.

## 5.0 Conclusions

Thus, based on these findings, it can be concluded that the existence of independent directors represents a vital element of the corporate governance due to reason that they significantly influence a company's performance in particular of the Malaysian PLCs. The discrepancies between the two findings of the analyses showed that the panel data technique is better off compared to the cross sectional analyses in explaining the relationship among the variables. This is due to reasons for the advantages of using the approach which assumes that the individual firms are heterogeneous compared to the cross sectional studies that do not have control over the heterogeneity, thereupon, leads to the risk of obtaining biased results (Hsiao 1985, 1986). Meanwhile, another study of a recent research by Shukeri, Ong, and Shaari (2012) also found out that a cross sectional study does not provide a generalized result on the overall influence of corporate governance towards a firm's performance due to reason that it only concerns a single period of study.

While, this may be true for cross sectional study, its weaknesses, however, did not overwhelm the findings of this research as can be noted for some significant correlation among the variables shown under the panel data technique. The results had, therefore, supported other related studies (Li, Zong-jun, and Deng, 2008; Choi, Park, and Yoo, 2007 and more) which suggested the vital reason for the presence of the independent directors to monitor the company's performances. Not to mention, the findings of this study had also strengthened the belief that independent directors are seen as the trustees and the best guarantor of good corporate governance (Bose, 2009). This convinces the shareholders and potential investors that they are being protected at the assurance of their existence in a company. In particular of their roles towards a company's performance, Uzun, Szewczyk, and Varma (2004) found out that the independent directors' existence in a company did not only resulted in a declination of a corporate fraud as their proportion increases, but also the financial information provided by the firms with a majority of independent directors were better able to predict bankruptcy. Significantly, previous study had also claimed that there is a positive correlation between the greater proportion of non-executive directors and the ability to control for management self-interest which in return resulted in a less earnings manipulation as they represent part of the company's audit committee (Klein, 2002; Chhaochharia and Grinstein, 2004). Undoubtedly, the presence of independent directors as part of the BOD membership highlighted an important requirement by both MCCG as can be seen from the findings of this study which emphasized dividend yield and earnings per share to uniquely measured company's performances based on the panel data technique. On the other hand, the characteristic of the company with or without Shariah Compliance does not appear as a critical element to influence Malaysian public listed companies' performance in relation to the reformation of MCCG 2007. However, it should be consider the limitations of this study due to limited elements of corporate governance, fewer sample size for non-Shariah compliance and special industries may not render the results of the study to be generalized.

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