



GOVERNANCE MECHANISMS
AND CORPORATE PERFORMANCE
OF STATE GLCs IN BURSA MALAYSIA

BY

MOHD HAFIZ BIN HARUN

A dissertation submitted in partial fulfilment of the
requirements for the degree of Master of Science
(Accounting)

Kulliyyah of Economics and Management Sciences
International Islamic University
Malaysia

JULY 2010

ABSTRACT

State GLCs, as the financial arms of the State governments, are important profit-making entities to the development of the state economies. But, little is known about them. Learning from the Federal GLCs that went through the Transformation Program, none was however initiated for the State GLCs. With this, knowledge on the performance and corporate governance of the State GLCs need to be investigated. Consequently, by comparing the performance of the State GLCs with the performance of the Federal GLCs, the researcher is more interested in studying the performance of the State GLCs. The main objective of this study is examine whether there are significant differences that exist in the performance of both the State and Federal GLCs when considering the relationship between the firms' performance in terms of; (1) financial performance; (2) Social performance towards (a) employees, (b) suppliers and (c) government; (3) environmental performance and (4) certification performance. Secondly, the study examines the impact of the six governance mechanisms; (i) board composition (IndDir), (ii) accounting literacy of audit committee members (AudCom), (iii) size of directors' nomination committee (NomiCom), (iv) size of directors' remuneration committee (DirRem), (v) internal audit function (InAud) and (vi) size of external auditor firm (ExAud), on the firms' performance for the financial year 2006-2007. The sample companies in this study are mainly listed on the main board of Bursa Malaysia and a few are from the second board. Overall findings suggest that there is no significant difference in the performance of both types of companies except for the financial performance in which the State GLCs underperformed compared with the Federal GLCs. Secondly, the findings also indicate that some of the governance mechanisms such as proportion of independent directors and size of directors' nomination committee together with control variables, firm size and leverage have a negative impact on firms' performance. Besides that, the size of directors' remuneration committee and industry type also has a positive impact on the performance of both the State and Federal GLCs. However, results show that the audit-related mechanisms do not have any significant impact on the performance. Finally, the findings denote the incompetency of the independent directors of both the State and Federal GLCs have some impact on the performance of these companies in some areas. Hence, effectiveness of training and courses conducted for the independent directors need to be reviewed in order to help them in enhancing the performance of the companies.

ملخص البحث

تعتبر الشركات ذات الارتباط الحكومي العمود الفقري لتطوير الاقتصاد الماليزي على مستوى الولايات وعلى المستوى العام، ولكن ما هو معروف عن هذه الشركات على مستوى الولايات يعتبر القليل من ما يتضمنه جوهر هذه الشركات. ان الهدف الرئيسي من هذه الدراسة هو اختبار ماذا كلن هناك اختلاف احصائي بين اداء النوعين من الشركات مع الاخذ بالاعتبار العلاقة بين اداء الشركات من النواحي الاتية (1) الاداء المالي (2) الاداء الاجتماعي تجاة العاملين والموردين والحكومة (3) الاداء البيئي (4) الاداء المشهود او الموثق والمرتبط بشهادات الجودة. من الناحية الاخرى تهدف هذه الدراسة الى معرفة اثر اليات حكومة الشركات على على الاداء المالي لسنة 2006-2007 وعلى وجه التحديد تنظر هذه الدراسة الى الاليات الاتية (1) استقلال مجلس الادارة (2) المستوى التعليمي لاعضاء لجنة المراجعة (3) عدد اعضاء مجلس الادارة (4) عدد اعضاء لجنة التعيين (5) العائد المادي لاعضاء مجلس الادارة (5) جودة الرقابة الداخلية (6) حجم المراجع الخارجي. تتمثل عينة هذه الدراسة بشكل اساسي على الشركات المدرجة في البورصة الماليزية في الدرجة الاولى كما ان القليل منها في الدرجة الثانية. بشكل اجمالي توصلت هذه الدراسة الى ان ليش هناك اختلاف جوهري بين اداء النوعين من الشركات قيد الدراسة من جميع النواحي ماعدا الاداء المالي والذي يظهر ان الشركات التابعة للحكومة المصغرة او التابعة للولايات تعتبر اقل اداء من الشركات التابعة للحكومة المركزية. ثانيا نتائج هذه الدراسة تشير الى استقلالية مجلس الادارة وحجة لجنة التعيين وحجم الشركة وحجم الديون لها اثر سلبي على اداء الشركات المالي. بالاضافة الى ذلك حجة لجنة التعيين ونوع الصناعة او القطاع يوتر ايجابيا على اداء الشركات في كلا النوعين من الشركات. اصف الى ذلك الخصائص المرتبطة بالتدقيق ليس لها اثر على اداء الشركات. اخيرا كفاءة اعضاء مجلس الادارة لها اثر على الاداء في كلا النوعين ن الشركات ولذلك لابد من عمل برامج تدريبية لهؤلاء الاشخاص لغرض تحسين ادائهم.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Sciences (Accounting).

.....
Hafiz Majdi Abdul Rashid
Supervisor

.....
Muslim Har Sani Mohamad
Co-Supervisor

I certify that I have read this study that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Accounting).

.....
Nazli Anum Mohd Ghazali
Examiner

This dissertation was submitted to the Department of Accounting and is accepted as a partial fulfilment of the requirements for the degree of Master of Sciences (Accounting).

.....
Hafiz Majdi Abdul Rashid
Head, Department of Accounting

This dissertation was submitted to the Kulliyah of Economics and Management Sciences and is accepted as a partial fulfilment of the requirements for the degree of Master of Sciences (Accounting).

.....
Khaliq Ahmad
Dean, Kulliyah of Economics and
Management Sciences

DECLARATION PAGE

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Mohd Hafiz bin Harun

Signature

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION
OF FAIR USE OF UNPUBLISHED RESEARCH**

Copyright © 2010 by Mohd Hafiz Harun. All rights reserved.

**GOVERNANCE MECHANISMS AND CORPORATE PERFORMANCE
OF STATE GLCs IN BURSA MALAYSIA**

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Mohd Hafiz Harun

.....
Signature

.....
Date

I wish to dedicate this thesis to my beloved mother and my father who taught me never to give up and whose influence has been lifelong and has shaped my aspirations and goals. I also dedicate this thesis to my beloved wife, my daughter, my family, my friends and the Muslim Ummah.

ACKNOWLEDGEMENTS

In the name of Allah, the Most Compassionate and the Most Merciful.

First and foremost, (*Alhamdulillah*) all praises be upon Allah, Lord of the Universe for all blessings that He has given His' creatures. And may His blessings, peace and favours descend in perpetuity on our beloved Prophet Muhammad (PBUH), who is mercy for the entire world. Truthfully, without Allah's blessing, grace and guidance, this thesis could not have been written.

There are many people I would like to thank for enabling me to reach this stage of my Master. First, I want to express my deepest gratitude to my principal supervisor Dr. Hafiz Majdi Abdul Rashid and Dr. Muslim Har Sani Mohamad without whose encouragement, scholarly support and commitment of time, this thesis would not have become a reality. I would also like to record my sincere appreciation to my lecturers for their guidance and encouragement which have enabled me to acquire precious knowledge.

I would like to convey my highest appreciation to my beloved mother and father, Puan Zainun bt Che Mohd and Harun bin Nong for their continues supports, encouragements and advices. The miracles of their do'a and hopes are the catalyses of my strength to complete this thesis. My grateful thanks go to my wife Raihan Tahkin and my children Nazurah and Fakhurrazi, who gave up so much in order for me to complete this study. Over the months there have been many disturbed early mornings since the most productive working hours for me are after midnight till dawn.

Last but not least, my deepest appreciation goes to the Dean of Management and Economics Faculty of University Malaysia Terengganu (UMT) Prof. Shamsul Nahar Abdullah and former and current Head of Accounting Department, Dr Zulkifli Mokhtar and Dr Mohd Hassan Che Haat for their supports and, after the guidance of Allah, without them, I would not have completed this work. My sincere respect to the officers and staff of Ministry of Higher Education for giving me chance to pursue my studies under the Bumiputra Academic Training Scheme (SLAB). Finally, if this modest effort is successful, it is by Allah's grace and guidance and if it falls short of the readers' expectations, we can only pray and hope that Allah will forgive me.

TABLE OF CONTENTS

Abstract	i
Abstract in Arabic	ii
Approval Page.....	iii
Declaration Page	v
Copyright Page.....	vi
Dedication	vii
Acknowledgements.....	viii
List of Tables	xii
CHAPTER ONE: INTRODUCTION	1
1.0 Introduction	1
1.1 Motivation of the study.....	4
1.3 Objectives of the Study.....	5
1.4 Research Objectives and Research Questions	6
1.5 Significance of the Study.....	7
1.6 Organization of the Dissertation.....	8
CHAPTER TWO: LITERATURE REVIEWS	10
2.0 Introduction	10
2.1 Corporate Governance.....	11
2.2 Corporate Governance in Malaysia.....	14
2.3 Review of Literatures.....	17
2.4 Governance Mechanisms.....	18
2.4.1 Board Composition	19
2.4.2 Audit Committee	22
2.4.3 Directors' Nomination Committee.....	24
2.4.4 Directors' Remuneration Committee.....	25
2.4.5 Internal Audit function.....	27
2.4.5.1 In-house or Outsource?.....	28
2.4.6 External Auditor.....	31
2.5 Controlling variables	33
2.5.1 Industry Type	33
2.5.2 Firm Size	34
2.5.3 Leverage.....	34
2.6 Conclusion	35
CHAPTER THREE: GOVERNMENT-LINKED COMPANIES (GLCs)...	36
3.0 Introduction	36
3.1 Privatization in Malaysia.....	37
3.2 Federal and State Government	40
3.2.1 Federal Government.....	40
3.2.2 State Government.....	40

3.3 Federal GLCs and State GLCs	42
3.3.1. Federal GLCs	42
3.3.2. State GLCs	44
3.4 Putrajaya Committee for GLC High Performance (PCG).....	45
3.5 Conclusion	48
CHAPTER FOUR: HYPOTHESES DEVELOPMENT	49
4.0. Introduction	49
4.1 Theoretical Perspective.....	49
4.1.1. Stakeholder theory	49
4.2. Corporate Performance.....	51
4.3. Governance Mechanisms.....	53
4.3.1 Board Composition	54
4.3.2 Audit Committee.....	56
4.3.3 Directors' Nomination Committee.	58
4.3.4 Directors' Remuneration Committee.....	60
4.3.5 Internal Audit function.	62
4.3.6 External Auditor.....	64
4.3.7 Industry Type	66
4.3.8 Firm Size	66
4.3.9 Leverage.....	67
4.4. Conclusion	68
CHAPTER FIVE: RESEARCH METHODOLOGY.....	69
5.0 Introduction	69
5.1 Data Collection Method.....	69
5.2 Sample Selection and Data Collection	70
5.3 Variables Measurements.....	73
5.3.1 Dependent Variables	73
5.3.2 Independent Variables	79
5.3.3 Control Variables	81
5.3.3.1 Industry Type	81
5.3.3.2 Firm Size	81
5.3.3.3 Leverage.....	82
5.4 Data Analysis Techniques.....	82
5.5 Model Development.....	84
5.6 Conclusion	84
CHAPTER SIX: FINDINGS AND ANALYSIS.....	85
6.0 Introduction	85
6.1 Descriptive Analysis.....	85
6.2 Univariate Analysis (Mann-Whitney U-Test)	100
6.2.1. Results for performance of State and Federal GLCs	100
6.3 Correlation Analysis.....	106
6.3.1 The Results – Multivariate Analysis: Governance Mechanisms and Firm Performance	109
6.4 Conclusion	118

CHAPTER SEVEN: DISCUSSION AND CONCLUSION	119
7.0. Introduction	119
7.1. Summary of the study	119
7.1.1. The Study	119
7.1.2. Discussions on the Findings.....	121
7.1.2.1 Corporate Performance	121
7.1.2.2 Governance Mechanisms and Corporate Performance.....	123
7.2. Implications and Recommendation of the Study	130
7.3. Limitations and Suggestion for Future Research	133
7.4. Concluding Remarks	134
BIBLIOGRAPHY	136

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
5.2	List of industry types and number of samples for State GLCs and Federal GLCs.	72
5.3 (a)	Definitions of dependent variables used in analyses	77
5.3 (b)	Definitions of dependent variables used in analyses	80
6.1 (a)	Descriptive statistics of all variables	87
6.1 (b)	Descriptive statistics of the ROA (Financial performance)	88
6.1 (c)	Descriptive statistics of the SocEmp (Social performance towards Employees)	88
6.1 (d)	Descriptive statistics of the SocSup (Social performance towards Suppliers)	90
6.1 (e)	Descriptive statistics of the SocGov (Social performance towards Government)	90
6.1 (f)	Descriptive statistics of the Enviro (Environmental performance)	91
6.1 (g)	Descriptive statistics of the Cert (Certification performance)	92
6.1 (h)	Descriptive statistics of the IndDir (Proportion of Independent Directors on the board)	93
6.1 (i)	Descriptive statistics of the AudCom (Proportion of Audit Committee members with accounting literacy.)	93
6.1 (j)	Descriptive statistics of the DirRem (Size of directors' remuneration committee)	95
6.1 (k)	Descriptive statistics of the NomiCom (Size of directors' nomination committee.)	96

6.1 (l)	Descriptive statistics of the InAud (Internal Audit Function.)	96
6.1 (m)	Descriptive statistics of the ExAud (Size of External Auditor.)	97
6.1 (n)	Descriptive statistics of the FSIZE (Total Assets)	98
6.1 (o)	Descriptive statistics of the LEV (Total debt over equity value)	99
6.2.1 (a)	Mann-Whitney U-test for State and Federal GLCs for year 2006 and 2007	105
6.2.1 (b)	Summary of hypotheses and the findings	106
6.3 (a)	Multicollinearity Test - Bivariate Pearson Correlation for all sample of companies (2006 & 2007)	108
6.3.1 (a)	Multivariate regression analysis of performances for all sample companies (2006 & 2007)	116
6.3.1 (b)	Summary of hypotheses, findings and explanation on significance	117
7 (a)	Summary of hypotheses and the findings	121
7 (b)	Summary of hypotheses, findings and explanation on significance	124

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

Principles of corporate governance have imposed themselves as the essential rules for any well-run company to follow. For the last decade or so, corporate governance has become a very topical issue. Discussions on corporate governance in Malaysia as well as other East Asian countries have been initiated since the 1997-1998 Asian Financial Crisis. This was so as the governments of the countries severely affected by the crisis had registered budget surpluses in the years prior to the crisis. According to IMF (1999), the crisis was exacerbated by weaknesses in the domestic policy of the East Asian economies. As a matter of fact, the East Asian economies collapse significantly impacted upon the structure of the Malaysian economy.

These impacts have led the government of Malaysia to undertake a number of steps to strengthen the economy, including the financial and operational restructuring of companies and acquiring large stakes in several corporations (The Putrajaya Committee on GLC High Performance [PCG], n.d.). The government has played its part as the engine of economic recovery while the private sector must resume its role as the engine of economic growth. The concerted efforts of the government and the private sector at crisis management have resulted in the nation emerging having a stronger grip in all aspects of the economy, from the financial system, covering the banking system and the capital markets, to the corporate sector. In particular, the corporate sector has emerged stronger through financial and operational restructuring, with stronger balance sheets and improved corporate governance. This period and the subsequent recovery also saw a greater role for the government in economic

management includes in the banking and corporate sectors, that has resulted in several large and strategic corporations coming under government ownership and control (PCG, 2005).

As a continuous effort to strengthen the Federal GLCs' economic and financial position, the Malaysian government undertook the recommendations of the Putrajaya Committee for GLC High Performance (PCG) and launched GLCs Transformation programme in May 2004. The transformation of the Government-Linked Companies (GLCs) into high-performing entities is critical for the future prosperity of Malaysia (PCG, 2005). The policy guidelines in the manual are set to achieve various objectives, including, to clarify the Federal GLCs mandate in the context of national development. The Federal GLCs transformation programme, encompassing part of a larger national development strategy, focuses on enhancing performance and takes full cognizance of matters relating to governance, shareholder value and stakeholder management.

Under the Federal GLCs transformation policy, there are three underlying principles of the GLC transformation programme; national development foundation, performance focus and governance, shareholder value and stakeholder management (PCG, 2005). First, in terms of national development foundation, the GLC transformation programme seeks to foster growth with equity, to improve total factor productivity, develop human capital and develop the Bumiputra community. Second, the focus on performance aims to improve both economic as well as the shareholder value of the Federal GLCs. Finally, the Federal GLCs are expected to observe good governance practices with both its shareholders and the wider stakeholders. Thus, the Federal GLCs are expected to be involved in stakeholder engagements with the

diverse a group of constituents ranging from employees, customers and suppliers to the government itself (PCG, 2005).

The financial crisis has also highlighted the significance of good corporate governance and best business practices of many countries in this part of the world. There is a growing recognition that good corporate governance is essential to protect the interests of investors, shareholders, bankers and insurers, and the public at large. (Assistant Governor, 4 April 2000). Corporate governance has become a buzzword in the light of recent high profile corporate failures.

Besides the impact of the 1997 economic downturn, Malaysia also experienced a number of financially distressed companies as a result of manipulation and fraudulent activities. Companies like Malaysian Airline Systems (MAS), Transmile and Perwaja Steel Sdn Bhd found themselves in going concern problem as a consequence of not being properly managed and governed in the day to day activities of the company. The mismanagement of such companies has also introduced to the public the ethical question of corporate governance. Public confidence in corporate governance structures and the ability of corporate boards to monitor and control management's behavior has eroded to very low levels (Petra, 2005).

Researchers, academicians as well as practitioners (either professionals or regulators) are and have been searching for the cause of the collapse of governance. Where did it went wrong; whether it was the people entrusted with it (the board of directors, the management and the audit committee) or whether it was due to insufficient regulation (securities commission guidelines, stock exchange requirements etc) or other factors such as the industry itself, demographic or firm-characteristics. What is more important is that those companies that have problems with its corporate governance did not only affect the shareholders of those companies

alone but also the other stakeholders, especially the government and the public at large.

The issues of corporate governance and the research for an optimal governance structure have received considerable attention in conventional economic literatures and public policy debates due to the growth of institutional investors, the shortcomings of contemporary monitoring and control of corporation (Iqbal and Mirakhor, 2004).

1.1 MOTIVATION OF THE STUDY

This study is inspired by the fact that State GLCs, the financial arms of the State governments, are important profit-making entities to the development of the state economies. But, little is known about them. Learning from the Federal GLCs that went through the Transformation Program in 2006, none was however initiated for the State GLCs. With this, knowledge on the performance and corporate governance of the State GLCs need to be investigated. Consequently, by comparing the performance of the State GLCs with the performance of the Federal GLCs, the researcher is more interested in studying the performance of the State GLCs.

This study is also initiated in the belief that, to the best of the researcher's knowledge, most of the previous studies on corporate governance are done with regards to the Federal GLCs and no empirical study in the context of Malaysia that gave concentrated on the governance mechanisms in the State GLCs and their relationship with the firms' performance. Hence, it is hoped that this study will fill the gap in understanding about the corporate governance in companies owned by both the State and Federal governments of Malaysia.

1.2 OBJECTIVES OF THE STUDY

The present study generally aims to serve as an exploratory study on the corporate governance of both the State and Federal GLCs in Malaysia. The study focuses on the characteristics of the corporate governance systems in both the State and Federal GLCs in relation to the introduction of the Malaysian Code on Corporate Governance and also the development of the Transformation Policy of Government-Linked Companies by the Putrajaya Committee for GLC High Performance (PCG). Secondly, the study intends to compare the performance of State GLCs with a matched sample of Federal GLCs for the period 2006-2007. This study intends to assess as whether any significant difference exist in the performance of these two groups when taking into account the governance mechanisms practiced (i.e. board composition, audit committee, directors' nomination and remuneration committee and internal audit function) and their relationship with the companies' performance. Both the State and Federal GLCs are evaluated in terms of their financial, social, environmental and certification performance. Besides concentrating on the typical discussion on the governance mechanisms, the study also tries to investigate the relationship between the sizes of external auditors' firms with the companies' performance. Emphasis on the size of auditors' firms is placed after taking into account that different types of the auditors may provide different quality of audit and professional judgments to the auditee. Moreover, the consultation and advice given by the auditors may vary according to their experience and competency.

1.3 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS

As mentioned in the previous chapter, there is no comprehensive study on the corporate governance practices in the State GLCs. Hence, this research is carried out with the aim of examining as to whether there are differences in the governance mechanisms employed in the State and Federal GLCs and their relationship with corporate performance. To meet the objectives of the study, the research questions attempt to explore the significance of governance mechanisms practiced on the corporate performance of the State and Federal GLCs. Therefore, two types of research question have been developed i.e. general research question and specific research questions. The research questions are as follows:

General Research Question:

Is there any relationship between governance mechanisms and corporate performances of State and Federal GLCs?

Specific Research Question 1:

Is there any difference in performance of State when compared to Federal GLCs?

Specific Research Question 2:

Is there any difference in significance of governance mechanisms on the State and Federal GLCs in terms of financial, social, environmental and certification performance?

1.4 SIGNIFICANCE OF THE STUDY

In the first place, this study first of all, hopes to address the inadequacies of previous studies done in the area of corporate governance in Malaysia which only focused on the Federal GLCs. Thus by addressing governance issues related to State GLCs, this current study serves to complement the knowledge on the understanding of corporate governance practices in Malaysia. A strong understanding of this will give a clearer picture of the principles and objectives of the Malaysian Code on Corporate Governance as well as a broader perspective about corporate governance practice in Malaysia.

It is also anticipated to enhance the awareness about the importance of proper governance of companies and its relation to performance. Moreover, findings of this study may be useful for State GLCs to implement the best governance structure to boost their performance by way of maximizing the wealth of shareholders and at the same time provide optimal values to various stakeholders of the companies. This is parallel to what is suggested by Jensen and Meckling (1976); different parties have their own utility maximizer.

Considering the complexity in the business environment today, this study also hopes to be able to inculcate a higher corporate governance culture in Malaysia as well as to provide a conducive environment for business activities. Last but not least, this study aims to contribute to a growing literature in the context of corporate governance in Malaysia.

1.5 ORGANIZATION OF THE DISSERTATION

This thesis will be organized into five chapters, including this chapter, which signifies the introductory chapter of the thesis. This chapter provides a brief explanation of the background, objectives and motivation, as well as a brief description of the significance of the study.

The rest of the dissertation is organized as follow: Chapter 2 reviews the literature on corporate governance practices and its development in Malaysia. This is followed by a discussion of prior studies and their findings on the relationship between governance mechanisms and corporate performance. The reviews are structured into six sections namely; board composition, audit committee, directors' nomination and remuneration committee, internal and external audit functions. In addition, the literature also discusses the control factors such as industry type, size of company and leverage.

Chapter 3 mainly focuses on the development of government-linked companies (GLCs) in Malaysia. The first part of the chapter is about privatization of GLCs and role of GLCs in Malaysian economy. In addition, it also investigates the involvement of the government in the economy and the GLCs. Besides that, this chapter also introduces the types of governments in Malaysia namely the Federal and the State governments. It also provides descriptions and discussions on the State and Federal governments. This is followed by some elaboration about the State GLCs and Federal GLCs in Malaysia. Last but not least, there is also a discussion on the introduction of GLCs Transformation Programme by the Putrajaya Committee for GLC High Performance (PCG). Development of such a programme has inspired the researcher to conduct this study to gain more understanding about the characteristics and performance of both the State and Federal GLCs.

Subsequently, Chapter 4 provides detailed information on the research methods used for data collection, sample selection, procedures, together with their justifications. Chapter 5 explains the theoretical perspective and the development of the hypotheses plus a discussion on the variables and the measurements that are obtained from the annual reports of the selected sample companies.

In the sixth chapter, the resulting data is discussed. In this chapter the researcher analyzes secondary data collected from annual reports, and provides interpretations of the findings of the study. Descriptive statistics are used.

Finally, the study is concluded in Chapter 7. This chapter summarizes the findings according to the parts of the research questions. It also addresses the contribution of the study. Finally, it explains the limitations and areas for future research.

CHAPTER TWO

LITERATURE REVIEWS

2.0 INTRODUCTION

This section looks at a number of studies which are done in corporate governance area. This is organized with the purpose of finding gaps which may exist between studies done previously. Moreover, methodologies used in those studies may guide the researcher to develop his own model and research design.

The first part of this section focuses on the definition of corporate governance as well as description on its nature and characteristics. This is followed by discussion on corporate governance in Malaysia. By highlighting the efforts reflected in Malaysian Code of Corporate Governance (the Code), this part talks about development of corporate governance practices in Malaysia and practices of the written Code for companies to follow together with efforts by Malaysian government in ensuring good governance in corporate environment. The review of literatures will be discussed according to the governance mechanisms of the Malaysian Code of Corporate Governance (The Code) and empirical evidences related to them. The reviews highlight issues discussed in prior studies with regards to governance mechanisms as independent variables tested in this study. In addition, related literatures concerning about three control variables of this study also being discussed. This chapter is wrapped up with concluding remarks of the whole discussion in this chapter.

2.1 CORPORATE GOVERNANCE

Corporate governance, as a concept, became diverse over a period of time. There are many different definitions of corporate governance. It can simply be referred to as the system in which companies are governed and controlled (Cadbury Committee Report 1992). It provides ‘architecture of accountability – the structures and processes to ensure companies are managed in the interests of their owners. Parum (2005) describes corporate governance as a set of principles concerning the governing of companies and how these principles are disclosed or communicated externally.

Looking from a broader perspective, Shleifer and Vishny (1997) view corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Their theme is that corporate governance deals with the agency problem: the separation of management and provider of finance. Meanwhile, Gillan and Starks (1998) define corporate governance as the system of laws, rules, and factors that control operations at a company in which it provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Corporate governance also refers to the method by which a corporation is directed, administered or controlled. It includes the laws and customs affecting that direction, as well as the goals for which it is governed. Corporate governance principles and guidelines are established by several organizations to provide best practices or to benchmark against which to assess the appropriateness of the corporate governance practices (Rezaee et.al, 2003). Furthermore, corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. Corporate governance is a collection of