MULTIPLE DIRECTORSHIPS, DILIGENCE AND FIRM PERFORMANCE: AN EMPIRICAL ANALYSIS OF MALAYSIAN PUBLIC LISTED COMPANIES

BY

SITI BALQIS BINTI MOHD NOOR

A dissertation submitted in fulfilment of the requirement for the degree of Master of Science in Accounting

Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia

OCTOBER 2015

ABSTRACT

Multiple directorships are found to be common among outside directors (KPMG, 2009). The fact that these directors are busy and may lack the time to carry out their duties effectively and efficiently initiated the issuance of a requirement under the Bursa Malaysia Listing Requirements to limit the number of directorships held by an individual director to five (BM, 2012). Previous literature however, does not show robust findings concerning the ineffectiveness of these directors in performing their role. Using samples of Main Market Bursa Malaysia firms, this study aims to examine the impact of multiple directorships and diligence on firm performance and investigate the presence of moderating effect of diligence especially in the context of Malaysia. Multiple directorships are measured by the number of outside directorships held by independent directors and diligence is measured by the number of board meeting attendance of independent directors. Two theories are employed in this study which is agency theory and resource dependence theory. The results revealed that a higher number of multiple directorships results in higher firm performance, and no significant relationship is found between diligence and firm performance. Besides, the results also showed that the attendance at board meetings of independent directors with multiple directorships does not add value to firms.

خلاصة البحث

انتشر تعدد الإدارات لدى المدراء الخارجين(KPMG,2009). وفي الواقع أنهم مشغولون وقد لا يجدون وقتا كافيا للقيام بواجباتهم بشكل فعال مما يؤدي إلى إصدار شرط تحت متطلبات الإدراج لبروصة ماليزيا هو تحديد عدد الإدارات التي يعقدها المدير الفردي إلى خمسة (BM,2012). ومع ذلك أن الدراسات السابقة لا تظهر نتائج واضحة حيال عدم فعالية هذه الإدارة في أداء دورها. و باستخدام عينات من شركات السوق الرئيس لبورصة ماليزيا، تهدف هذه الدراسة إلى استقصاء أثر تعدد الإدارات مع وجود المثابرة على أداء الشركات في سياق ماليزيا. يتم قياس تعدد الإدارات من خلال عدد من الإدارات الخارجية التي يعقدها المدراء المستقلون، وتقاس درجة المثابرة من خلال عدد الحضور لمجلس الاجتماع لدى المدراء المستقلين. يتم تطبيق نظريتين في هذه الدراسة، أولهما نظرية الوكالة والثاني نظرية الاعتماد على الموارد. وكشفت نتائج الدراسة عن ارتفاع تعدد الإدارات يؤدي إلى ارتفاع أداء الشركات، وعدم وجود علاقة ذات دلالة إحصائية بين المثابرة وأداء الشركات. ثم أظهرت النتائج أن الحضور في مجلس الاجتماع لدى المدراء المستقلين لا يضيف أي قيمة للشركات.

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 Science in Accounting.

....
Hafiz Majdi Ab. Rashid
Supervisor

I certify that I have 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 Science in Accounting.

....
Hairul Azlan Annuar
Examiner

....
Intan Suryani Abu Bakar
Examiner

This dissertation was submitted to the Department of Accounting and is accepted as a fulfilment of the requirement for the degree of Master of Science in Accounting.

....
Noraini Binti Mohd Ariffin
Head, Department of Accounting

This dissertation was submitted to the Kulliyyah of Economics and Management Sciences and is accepted as a fulfilment of the requirement for the degree of Master of Science in Accounting

....
Maliah Binti Sulaiman
Dean, Kulliyah of Economics and Management Sciences

DECLARATION

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.

Siti Balqis Binti Mohd Noor

Signature .... Date ....

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

DECLARATION OF COPYRIGHT AND AFFIRMATION OF FAIR USE OF UNPUBLISHED RESEARCH

MULTIPLE DIRECTORSHIPS, DILIGENCE AND FIRM PERFORMANCE: AN EMPIRICAL ANALYSIS OF MALAYSIAN PUBLIC LISTED COMPANIES

I declare that the copyright holder of this thesis/ dissertation are jointly owned by the student and IIUM

No part of this unpublished thesis may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without the 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.

By signing this form, I acknowledge that I have read and understand the IIUM Intellectual Property Right and Commercialization Policy

Affirmed by Siti Balqis Binti Mohd Noor

…………..…………. ……………….……..
Signature Date

ACKNOWLEDGEMENTS

In the name of Allah, the most Gracious and the most Merciful, Lord of the universe. Peace and blessings be upon Prophet Muhammad (pbuh). First of all, *Alhamdulillah* all praises be upon Allah SWT for graciously bestowing me the perseverance to undertake this research. I sincerely thank all those who have supported and helped me in writing this thesis report. A special thank and deepest appreciation to my supervisors, Assoc. Prof. Dr. Hafiz Majdi Ab. Rashid for his supervision, encouragement and advice throughout the completion of the thesis. I would also like to thank my examiners, Dr. Hairul Azlan Annuar and Dr. Intan Suryani Abu Bakar for the guidance and advice. Not forgetting my gratitude goes to my lecturers which have enabled me to acquire precious knowledge.

Secondly, many thanks to the Ministry of Higher Education (MOHE) of Malaysia and International Islamic University Malaysia (IIUM) for their financial support and assistance throughout the process of completing this research.

And thirdly, I would like to express my heartiest gratitude to my beloved parents; Mohd Noor bin Ismail and Rohani Lai Chor, beloved siblings; Siti Hajar, Siti Salwa, Muaz, Mohd Khomaini, Mohd Firdaus and Ahmad Salman, and all friends especially Salsabila, Izyan, Syazwani, Iffah, Hajjar, Amira, Naimah and Adibah for their patience, moral support and encouragements. The miracles of their do'a and prayers are the catalyses of my strength to complete this study. Finally, thanks to all postgraduate colleagues and staff in International Islamic University Malaysia (IIUM) for the support and encouragement throughout my studies.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

INED	Independent Non-Executive Directors
NED	Non-Executive Directors
MCCG	Malaysian Code of Corporate Governance
BM	Bursa Malaysia
SC	Security Commission
AT	Agency Theory
RDT	Resource Dependence Theory

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

The aim of this chapter is to provide an overview of the study. This chapter is organized into five sections. The first section presents the background of the study followed by the second section, which highlights the motivation of the study. The following section discusses the objectives of the study while the contribution of the study is presented in the fourth section. The last section in this chapter outlines the structure of the dissertation.

1.1 BACKGROUND AND PROBLEM STATEMENT

Mohamed Raslan Abdul Rahman, one of the managing partners of KPMG in Malaysia argues that "non-executive directors (NEDs) provide the relevant "check and balance" to the executives on the board" (KPMG, 2013). The importance of having NEDs on the board has been widely expressed by many parties including academicians and practitioners, as they are a key element of the board in providing monitoring and advising to firms. NEDs can be categorized into non-independent non-executive directors (NINEDs) and independent non-executive directors (INEDs) (KPMG, 2013; McCabe & Nowak, 2008; Sarkar & Sarkar, 2009). NINED is the NED who is not independent from management due to the past experience of working in the company as an executive or in any significant management position, while INED is the NED who is independent from management (McCabe & Nowak, 2008; Sarkar & Sarkar, 2009).

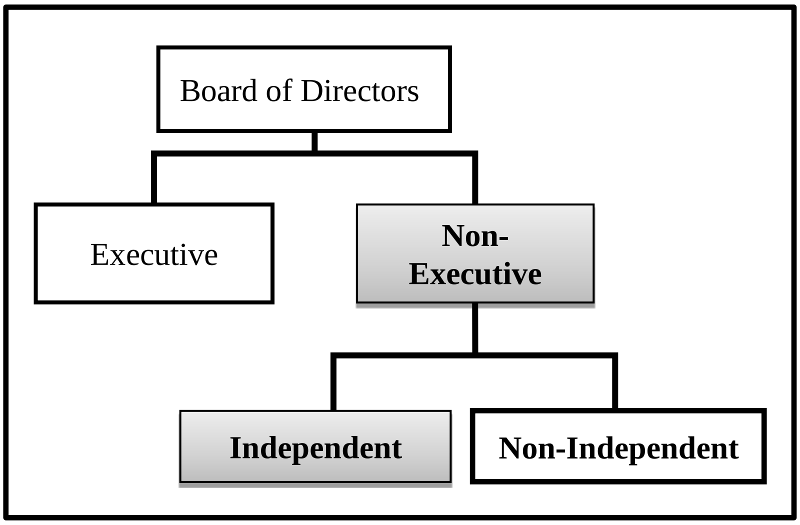

Figure 1.1 Board Composition
(KPMG, 2013; McCabe & Nowak, 2008)

The issuance of the Malaysian Code on Corporate Governance (MCCG) in 2000 raised many issues that sparked interest in the research area concerning the board (Kamardin & Haron, 2011; Ponnu & Karthigeyan, 2010), especially the requirement of the code for firms to have NEDs comprise at least one third of the board. According to the code (2000, 2007), the board should balance the number of executive and non-executive directors so that neither individual nor any small group of people can monopolise the board's decision-making.

Clearly, the existence of independent directors on the board may ensure the independency of the board, and thus become the most reliable representatives of the owners and other stakeholders of the firms to monitor the activities of the management (Abdullah, 2004). In addition, the independent directors' appointment is known to be one of the remedies to corporate governance problems, especially the principal-agent problem. This is supported by Lipton and Lorsch (1992) who suggest that the board should comprise at least two independent directors for the board to contribute to the improvement of the corporate governance.

Independent directors are widely considered to be outside directors who usually have full commitments or hold full time jobs in other organizations. They are also known to be highly skilled and widely experienced directors, and, thus, become desirable to many companies. The skills and knowledge possessed by independent directors are believed to be among the determinants of their appointment to the board. This is supported by KPMG (2013), which found that almost 60% of independent directors are financially literate (i.e. have an accounting, commerce, economics or legal background). Thus, independent directors are believed to benefit and add value to the firms, and, consequently, improve firm performance.

The issue of directors' effectiveness is always related to the issue of multiple directorships, which are found to be common among outside directors (KPMG, 2009). Prior literature presents mixed findings on the effectiveness of directors with multiple directorships, both inside and outside, on firm performance (Arosa, Iturralde, & Maseda, 2010; Ferris, Jagannathan, & Pritchard, 2003; Fich & Shivdasani, 2006; Kamardin & Haron, 2011). Some found directors with multiple directorships to be beneficial for firms as those directors are skilled and experienced, thus making them better advisors (Field, Lowry, & Mkrtchyan, 2013). This is consistent with the reputation hypothesis that suggests that directors gain value from the labour market by serving on multiple directorships (Fama, 1980).

However, as independent directors usually have full commitments in other organizations, they are also known as busy directors who hold more than one (Haniffa & Hudaib, 2006; Jiraporn, Davidson, DaDalt, & Ning, 2009, Lipton and Lorsch, 1992) or three (Ferris et al., 2003; Fich & Shivdasani, 2006) directorships in other firms. These busy directors have been found to be unrewarding to the firms as their busyness limits them in playing their role as monitors of the management (Fich &

Shivdasani, 2006). This is in accordance with the busyness hypothesis that argues that directors who sit on multiple directorships over commit themselves, and, thus, tend to be too busy (Chen, 2008a). The fact that these directors are busy and may lack the time to carry out their duties effectively and efficiently initiated the issuance of a requirement under the Bursa Malaysia Listing Requirements to limit the number of directorships held by an individual director to five (BM, 2012). Nevertheless, the appropriateness of this requirement is questionable, as research does not show robust findings concerning the ineffectiveness of these directors in performing their role. Therefore, in determining whether multiple directorships provide costs or benefits to firms, this study examines the relationship between independent directors with multiple directorships and firm performance by defining multiple directorships as the number of outside directorships held by independent directors.

KPMG, in their survey in 2013, identify some characteristics of directors who are considered as under-performing. One of the characteristics is the director who "has over-committed himself to other directorships, his personal affairs and business, or both". This overcommitting director may hardly make time to serve effectively, and, consequently, becomes a cost to the firm. In addition, it creates doubt as to whether these directors are able to attend annual board meetings in full or "might turn up for board meetings under-prepared" (KPMG, 2013). Examining the effects of busy directors on board meeting attendance, Jiraporn et al. (2009) found that busy directors "exhibit a higher tendency to be absent from board meetings". This has raised concerns about the diligence of independent directors with multiple directorships and the implications on firm performance.

The MCCG (2000, 2007) only states that the board should meet regularly but does not specify how frequently board meetings should be held. The frequency of board meetings will help the board to sense and detect any serious problems the company is facing, and, thus, enable the board to identify the solution quickly. In addition, as meetings are held frequently, many matters could be discussed that may provide firms with a remedy to cure any corporate governance problems. However, as the independent directors become busier, it is doubtful that these directors can still perform their jobs diligently and add value to the firms.

This study attempts to examine the costs and benefits of independent directors with multiple directorships in relation to the firm's performance, measured by Market Capital (MCAP). Conceptually, this study expands the current knowledge about multiple directorships and diligence by suggesting that independent directors with multiple directorships may be a cost or benefit to firms. Furthermore, the attendance of these directors at board meetings may also impact the firm performance, which provides an explanation of the directors' diligence. Moreover, it is proposed that the relationship between the independent directors with multiple directorships and firm performance will be moderated by the diligence of these directors. Therefore, given the importance of outside directors to corporate governance, it is appropriate to study the relationship between the independent directors with multiple directorships and firm performance, which is reflected in the market capital (MCAP) of the firms.

1.2 MOTIVATION FOR THE STUDY

Previous studies on corporate governance have mainly focused on a wide range of control mechanisms and governance structures to enhance corporate performance. This study adds to the discussion by focusing on the independent non-executive directors with multiple directorships and diligence by examining their impact on firm performance.

In addition, Bursa Malaysia, in its Listing Requirements 2012, also revised certain requirements, one of which one was limiting the number of directorships from ten to five. This shows that the issue of multiple directorships is important to be addressed as it has attracted the attention of regulator. Motivated by the move made by Bursa Malaysia, the current study relooks into the issue of multiple directorships from different scenarios.

Many studies have suggested a mixed impact of multiple directorships on firm performance. However, apart from attempting to look at the costs and benefits of independent directors with multiple directorships on firm performance, this study further examines the impact of multiple directorships on different types of firm, which are firms with greater need for advising and firms with greater need for monitoring, as suggested by Chen (2008a).

1.3 OBJECTIVES OF THE STUDY

The importance of having independent directors on the board has been highlighted by Bursa Malaysia and the Securities Commission. This study analyses whether directors with more than one directorship contribute to firm performance, and, at the same time, examines their diligence towards the studied firms, measured by board meeting attendance. Therefore, the following research objectives have been outlined to guide this study:

1. To examine the impact of multiple directorships on firm performance.
2. To examine the impact of diligence on firm performance.
3. To examine the moderating effect of diligence on the relationship between multiple directorships and firm performance.

In achieving the objectives outlined above, the following research questions have been structured to serve as guidelines for the current dissertation:

1. Is there any relationship between multiple directorships and firm performance?
2. Is there any relationship between diligence and firm performance?
3. Is there any moderating effect of diligence on the relationship between multiple directorships and firm performance?

Table 1.1 Summary of Research Objectives and Research Questions

No	Research Objectives	Research Questions
1	To examine the impact of multiple directorships on firm performance.	Is there any relationship between multiple directorships and firm performance?
2	To examine the impact of diligence on firm performance.	Is there any relationship between diligence and firm performance?
3	To examine the moderating effect of diligence on the relationship between multiple directorships and firm performance.	Is there any moderating effect of diligence on the relationship between multiple directorships and firm performance?

1.4 CONTRIBUTION OF THE STUDY

This study contributes to the corporate governance research area. First, it investigates the moderating influence of diligence on the relationship between independent directors with multiple directorships and firm performance, which, to the knowledge of the current author, has not been examined in any previous literature.

Secondly, it adds to the discussion on the costs and benefits of independent directors with multiple directorships and diligence from the Malaysian context, specifically among the public listed companies by employing the type I agency problem theory, which is the agency problem involving the owner and manager.

Furthermore, the current study employs a large dataset where data were collected from all public listed companies for the period of three years (i.e. 2009-2011). With such a large observations, the estimation from the regression analysis would be stronger, and conclusion on generalizability could also be made.

1.5 ORGANIZATION OF THE STUDY

The dissertation consists of six chapters. The present chapter provides an overview of the study and explains the significance of the study. Chapter two provides a review of the prior literature, which is relevant to the topics of board composition, board functions, multiple directorships, annual meeting attendance, and firm performance. Chapter three presents the theoretical framework and hypotheses of the study to explain the theories employed and the relationship between the board composition, multiple directorships, annual meeting attendance and firm performance. Chapter four explains the research methodology adopted for this research together with a brief discussion on the statistical tools used for data analyses. Chapter five covers the data analysis and results, and the last chapter concludes the study.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter reviews prior literature pertaining to the current study by providing an overview of the corporate governance mechanism (i.e. independent directors) and firm performance (measured by market capital). It covers a review of corporate governance and its relation to board of directors, particularly independent directors. The rest of the chapter is organized in the following manner. Section 2.2 discusses prior studies concerning the link between independent directors, multiple directorships and firm performance. The next section, 2.3, draws on the extant literature pertaining to independent directors with multiple directorships and diligence, followed by section 2.4 concerning the relationship between multiple directorships, diligence and firm performance. Section 2.5 identifies the literature gaps in this area, followed by section 2.6, which provides a summary of the chapter.

2.1 OVERVIEW OF CORPORATE GOVERNANCE

A gradual collapse of large and great companies around the world is argued to be the outcome of the failure of corporate governance mechanisms (Lipton and Lorsch, 1992). This has driven many parties including shareholders to demand more effective and efficient corporate governance mechanisms (Foo & Zain, 2010). Aligned with this demand, efforts have been taken by many countries to restore the stakeholders' confidence in corporate governance. In Malaysia, this initiative can be seen from the issuance of the Malaysian Code on Corporate Governance (MCCG) in 2000 by the Financial Committee of Corporate Governance, which was later revised in 2007. The revised MCCG 2007 focused primarily on strengthening the board of directors and audit committee and their effectiveness in playing their roles.

Foo and Zain (2010) argue that corporate governance is important to mitigate the issue of the conflict of interest between the management and the shareholders. As one of the very important corporate governance elements, the board of directors will be the first to be questioned should a firm fail. The board is viewed as a group of individuals who are mandated with responsibilities to protect the rights of the shareholders (Abdullah, 2004). Lipton and Lorsch (1992), in their proposal paper titled ‘Proposal for Improved Corporate Governance’, suggest that strengthening the board of directors’ role is vital for effective corporate governance and that it may help prevent minor problems from growing into a severe crisis.

Previous literature has mixed opinions concerning the main roles of the directors. Chou, Chung, and Yin (2013) suggest that the board has three main functions – monitoring, advising and contracting. Some emphasize the two main roles of the board of directors as being monitoring and advising (Field et al., 2013) while most solely focus on the monitoring role of the board (Ferris et al., 2003; Fich & Shivdasani, 2006; Kamardin & Haron, 2011). The current dissertation adds to this line of research by focusing on both the advising and monitoring roles of independent directors as there is still a lack of studies that examines the effectiveness of these directors in performing their functions.

As the board is the agent to the shareholders of the firm, one of their roles is to be a monitor to the management activities. The board is in the best position to monitor as they have access to the information and the power to oversee the performance of the management (Lipton and Lorsch, 1992). In addition, they should also act as a provider or advisor of knowledge to management where the inside directors may be the source of information about a company's activities while the outside directors may "provide both strategic input and objectivity in evaluating the executives' decisions" (Chen, 2008b; Chou et al., 2013).

In his speech explaining the roles of the board, Chancellor William Allen, a judicial scholar on corporate law, stated clearly the functions of the board as:

> the conventional perception is that boards should select senior management, create incentive compensation schemes and then step back and watch the organization prosper. In addition, board members should be available to act as advisors to the CEO when called upon and they should be prepared to act during a crisis… (as cited by Lipton & Lorsch, 1992, p.62)

He added that:

> …outside directors should function as active monitors of corporate management, not just in crisis, but continually; they should have an active role in the formulation of the long-term strategic, financial, and organizational goals of the corporation and should approve plans to achieve those goals; they should as well engage in the periodic review of short and long term performance according to plan and be prepared to press for correction when in their judgment there is need (as cited by Lipton & Lorsch, 1992, p.62)

2.1.1 Corporate Governance and Independent Directors

Both the monitoring and advising roles must be complemented with the right board as this determines how well the board functions. Board composition (i.e. a composition of outside and inside directors) is often seen as the main indicator of the right board. As board composition is one of the important attributes of the board of directors in which the effectiveness would affect firm performance (Kamardin & Haron, 2011), having the right board is thus critical for a firm's success. The importance of placing outside directors on the board can be seen from the issuance of a mandatory rule by the Securities Commission (2007) for firms to have at least three independent directors on the board.

Prior studies that have given considerable attention to board composition have looked at the determinants of board composition (Hermalin & Weisbach, 1988), the indicators of the right board (Lipton & Lorsch, 1992), the effectiveness of the board composition (Abdullah, 2004), and the relationship between board composition and the firm performance (Bhagat & Black, 1999; Kamardin & Haron, 2011). This indicates that board composition has a huge impact on firm’s corporate governance, and, consequently, firm performance.

Bhagat and Black (1999) argue that an optimal board comprises a mix of inside and independent outside directors, who introduce various skills and knowledge to the board. Compared to inside directors who are extremely knowledgeable regarding the firm's operations, the independent directors are often uninformed about what is happening inside the company. The independent directors are capable of acting promptly in a crisis because they are independent, but there is a tendency to do the wrong thing because they are ignorant and unknowledgeable of the fact.

It is suggested by Hermalin and Weisbach (1988) that the board composition is important for effective board monitoring, which can be best provided by the outside directors. Thus, having outside directors has been proven to be important in ensuring that the roles of the board function well (Fama & Jensen, 1983; Fama, 1980; Greco, 2011; Lipton & Lorsch, 1992), and, at the same time, ensure that the management act in the best interests of the firm’s shareholders and other stakeholders. It has also been argued that the inclusion of outside directors may ensure the effectiveness of the board as such directors “would bring independence in the board’s judgment” (Abdullah, 2004). In another study, Bhagat and Black (1999) believe that independent directors should not only be independent in fact but also in appearance yet provide reasonably balanced and accurate information for the company’s best interests. However, these