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Board of Director's Attributes as Deterrence to Corporate Fraud

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Abstract

Good corporate governance serves a great shield for the company to counter corporate fraud. Several attributes create good corporate governance and one of them is the board of directors. This paper examines the influence of board size, board meeting and board duality in deterring corporate fraud on 99 fraudulent companies listed under the Malaysian Securities Commission enforcement action for criminal prosecution or civil action regarding corporate fraud. These companies are then matched with another 99 non-fraudulent public listed companies in Bursa Malaysia. This study covered a period of ten (10) years, from the year 2000 until 2010. The panel data of ten (10) years was used to provide a stronger suggestion of causality via natural examination and subsequently, would provide better evidence from the analysis of board of director's attributes. Binary logistic regression analysis is used to analyse the data obtained. The result shows that there is a significant influence between the frequency of board meetings and corporate fraud. However, there is no significant influence between board size and board duality toward corporate fraud. This study concluded that in Malaysia the frequency of board meetings can be used as a method to deter corporate fraud. The findings will contribute to enhance the existing corporate governance policy in Malaysia to foster the achievement of zero corporate fraud.

Keywords: Corporate fraud; Board size; Board meeting; Board duality; Corporate governance

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1. Introduction

There is an alarming increase in corporate fraud as a result of the reduced capability of corporate governance to combat the problem. Poor corporate governance opens opportunities for an irresponsible person(s) to devise a sinister plan to be executed for personal gain. Corporate fraud not only adversely affects the company, but also the public at large, as demonstrated by Enron, WorldCom, Satyam Computers, Lehman Brothers and in the latest, Dell Incorporated. Malaysia too has a fair share of corporate fraud cases such as Baneng Holdings Berhad, Farlim Group (Malaysia) Berhad, and Satang Holdings Berhad. The latest corporate fraud cases involve C.I. Holdings Berhad, Chang Huat Corporations and Inix Technologies Holdings Bhd . This said, it is thus crucial for good corporate governance to be implemented in order to prevent corporate fraud from occurring. Good corporate governance would establish an effective shield for the company against corporate fraud at an early stage.

The Malaysian Institute of Corporate Governance (MICG) has come out with the Malaysia Code of Corporate Governance (MCCG) to strengthen the company's corporate governance. The guidelines cover several parties such as the board of directors and the audit committee. The implementation of corporate governance would provide an assurance to the shareholders that the company would protect their best interests. Further, the code would facilitate Malaysian companies to compete in the global market. The world economies today are moving toward market orientation. Malaysian companies thus need to be more proficient and well managed in order to compete in the global arena.

Several attributes are central in creating good corporate governance, one of which is the board of directors. The board of directors has a steward ship responsibility towards the shareholders, (MCCG, 2007). According to MCCG (2007), the board of directors' is responsible to review and adopt a strategic plan for the company; ensure that the company is properly managed; develop and implement shareholders policy in the company, among other tasks. The board of directors is also created to protect the company from corporate fraud. The board of directors not only monitors the company's activities but also influence it, which means that if there are any problems in the company, they can immediately tackle the problems before it gets worse (Dahya et al., 2003; Tong, 2003; Chen et al., 2006). According to the International Finance Corporation Family Business Governance Handbook (2010), the board of directors could provide additional skills, knowledge and expertise to the management of the company and the board's unbiased decision would provide assurance for shareholders to invest in the company.

The main issue that arises is whether the board of directors is capable to deter corporate fraud. If the board succeeds, it would reduce the chances for corporate fraud to occur. Hence, what are the attributes of the board that would ensure success in deterring corporate fraud? In conducting this study to look into this issue, there were several problems that arose, and one of them is monitoring the company's activities. It is argued that effective monitoring by the board of directors can be used as an indicator of the quality of the corporate governance in the corporation (Foo & Zain, 2010). Thus, if the company is effectively monitored, it would be able to deter corporate fraud. The other issue is regarding self interest in performing board of directors' duty. According to Carcello & Hermanson (2008), most fraud occurs due to the manipulation of the chairman or the CEO for his or her personal gain. Therefore, this study aim's to examine the influence of the board of director's attributes, specifically board size, board duality and frequency of board meeting in deterring corporate fraud in Malaysia.

This paper begins with a review of extant literature on corporate governance fundamentals and corporate fraud followed by the development of the hypothesis of the study. Then, it continues with research methodology that discusses the methods used to conduct this research, samples selection and data collection in order to analyse the variables selected. Next, the paper will discuss on data analysis and findings followed by a thorough discussion on the data analysis and the result of this research. The final section of the paper is conclusions drawn from this study. The paper also outlines the limitations of the study and future research to be further explored on this particular subject.

2. Literature Review

2.1. Corporate Fraud

The United States Department of Justice, Criminal Division (2004-2005: p.2.2) defined corporate fraud as: