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## Corporate Governance and Corporate Performance of Malaysian Companies: Examining from an Islamic Perspective

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### Abstract

Good corporate governance (CG) has been widely linked to the corporate performance. Based on the traditional agency theory, maximising the shareholders' value denotes the aim to gain better performance through profit maximisation. Taking from a different view, this study attempts to examine to which extent the companies with good CG scores will have good performance from an Islamic perspective (proxied by profit measurement). This study also intends to investigate whether the board attributes as internal governance mechanisms could exert significant influence towards a) overall corporate performance, and b) striving either for profit maximization or moderation. The data is gathered through conducting a content analysis of corporate annual reports of top 50 largest companies (which ranked based on good CG performance). The empirical results indicate that those directors who hold professional accounting qualification are statistically associated with lower total revenues. However, none of the directors' attributes appears to have significant association with the four proxies of corporate performance. The findings further provide evidence that all board attributes fail to prove their significant influence on the profit moderation as well as profit maximization.

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### 1. Introduction

This study attempts to examine the corporate performance of the companies with good corporate governance (CG) practices and to investigate the influence of CG mechanisms towards the corporate performance of these companies, from an Islamic perspective. It is based on the expectation that the increasing of corporate awareness to adopt such good CG practices are perform better than their counterparts (Mohd Ghazali, 2010). Taken the exemplary stories from the downfall of giant corporate scandals in the developed countries such as Enron, Worldcom (USA), Parmalat and Royal Ahold (EU), Nortel and Crocus (Canada), however there is no exception to the East Asian countries including

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Malaysia which suffered a severe financial crisis around 1997-1998. The lack of CG and transparency in disclosure were pervasively debated as the culprits of such economic aftermath. These scenarios of the corporate collapse and financial crisis seemed to provide a clear picture on the importance of having good CG practices in the notion that the unethical practices in the pursuit of self-interest may give an adverse impact to the firm's value as well as its constituents. Therefore, many countries' government, including the Malaysian government, has taken their great initiative to put CG reforms into existence which greatly assist in fostering the companies' commitment to improve their CG practices in a way to restore the confidence and better protection of the shareholders, who are the owners of the investment stake.

In Malaysia, among the earlier existence of CG reforms in the early 2000s were the Malaysian Code of Corporate Governance (the 'Code') and the Kuala Lumpur Stock Exchange (KLSE, which currently known as 'Bursa Malaysia') Listing Requirements which both have greatly emphasized on the enhancement of exercising CG practices and transparency disclosure towards the public listed companies. Since the listed companies are subject to publicly scrutinised by the regulators and shareholders, the incentives in the improvement of CG and information disclosure are due to promote the corporate accountability towards its shareholders as well as stakeholders. The corporate accountability level would determine the way the company is being operated and managed and its performance consequences since the shareholders rely heavily on the corporate performance (Abdullah 2004; Mohd Ghazali, 2010; Che Haat, Abdul Rahman and Mahenthiran, 2008). Given the prerogative accessible to management's daily operations and information, the managers have tendency to act in an opportunistic manner following to the selfish motive. Hence, the idea of conventional agency theory is created due to bridging the gap between the management and the absence of owners (shareholders) to the operational activities with the presence of a crucial monitoring mechanism, the board of directors (Jensen and Meckling, 1976; Watts and Zimmerman, 1986). In order to be competitive with other industry players globally, the issues of CG are an important matter to be drawn attentively for the sake of investing community at large at organizational level. This is because the minds of investors are already set with the expectation that those companies with good governance practices are able to drive better performance and better returns for their investment (Aras and Crowth, 2008), even though the prior studies which have sought to examine the relationship between CG and firm performance have well documented with mixed results (Bhagat and Black, 1999; Agrawal and Knoeber, 1996; Klapper and Love, 2004; Mohd Ghazali, 2010; Che Haat, et.al., 2008).

Most of the previous studies are prevalently measured the corporate performance from the lens of shareholders' value-maximization such as Return on Assets (ROA), Return on Equity (ROE) and Tobin's Q, however this study attempts to distinctively examine the corporate performance from an Islamic perspective which accounts for the element of profit (maximization or moderation) of firm business. Given the CG system in Malaysia is largely driven by the Anglo-American orientation through the emergence of the Code, this orientation is generally referred to the maximization of shareholders' value, in other words it is the shareholders-based CG system (Abdullah, 2004). This western-oriented CG motivates the companies to thrive their corporate performance which is based solely on the excessive economic motives. Unlike in the secular economic system where the profit maximization is emphasized, the Islamic economic system requires the firms to have some moral and ethical obligations while carrying out economic activities where the profit moderation is elucidated under the umbrella of Shariah framework (Azid, Asutay and Burki, 2007; Khatkhatay and Nisar, 2007). In this context, Islam advocates profit-making in business but at reasonable means, in other words the profit is obtained with full justice between the buyer and seller by charging at a just price and after considering all relevant costs that related to production without destroying other interests (Nik Yusoff, 2002; Gosh, Ghosh and Zaher, 2011). The profit maximization practice through over-charging price and unreasonably lower total costs are completely discouraged since it will lead to unfavourable exploitive aim to consumers. Hence, this practice is absolutely impermissible in Islam and it seems to show a large departure from the Shariah precepts which espouse a full spirit of solidarity and requires for balanced life among the humankind in order to attain life blessings from the God (Allah) in this world and in the Hereafter:

*"O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves (or one another). Indeed, Allah is to you ever Merciful" (An-Nisa': 29).*

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