The Impact of Corporate Governance on Firm's Financial Performance:A Comparison between Iranian and Malaysian Listed Companies

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Abstract: This study compares the impact of some corporate governance characteristics on firm performance of 87 companies listed on Tehran Stock Exchange and 96 companies listed on Bursa Malaysia. The aim of this study is to investigate the relationship between; percentages of directors' ownership, board size, percentages of non-executive directors, independency of chairman from CEO and performance of 183 companies in Iran and Malaysia between 2006 and 2010. Moreover, leverage ratio and firm size are used as control variables. This study is a practical research; the data is processed and analyzed by multiple regression models using E-views 7 software. The results show that except firm size which has a negative significant relationship with corporate performance, there is no significant association between corporate governance and firm's performance in Iranian companies'. But for Malaysian companies, the percentages of directors' ownership, CEO duality, firm size and leverage ratio have significant negative association with firm's performance.
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1. Introduction

From Organization of Economic Co-operation and Development perspective, corporate governance is about the relationship between managers, board's members, shareholders and other stakeholders. It prepares a mechanism to identify the goals of the companies, find the ways to access those goals and monitor the performance of companies (OECD, 1998). Every change in structure implementation of corporate governance leads to change in strategic direction, corporate performance and increase or decrease of agency costs. In recent years, the presence of different investors in shareholding of publicly-traded companies has enjoyed significant growth. Due to their important influence on the structure of ownership and their major effect on governance of companies, the existence of these investors' quality and quantity in industrial companies' ownership has received significant attention.

Jensen and Meckling (1976) defined agency costs as the cost of overuse of marginal profit of management. Moreover, according to calculation of Kaplan (1989) investors buy equity of common shareholder's in average 40% more than market value of shares. Clearly, the reason of this sharp rises in stock prices on these companies has been resulted from acquisition .Therefore, it is generally believed that increases in percentages of managers' ownership by reducing the lack of symmetry information, leading to a reduction in interest conflict between managers' and shareholders' interest.

Jensen (1993) stated that differences in institutional influences and economic conditions such as product markets, political and internal control system, different capital markets, regulatory and legal system may lead to an increased agency costs in different structures of ownership .Therefore, most of the relevant issues in the United Kingdom and United States companies may not be applied to developing countries (Craswell et al., 1997).

Despite a considerable literature focusing on the effect of corporate governance mechanism on firm's performance, much of these literatures are allocated to the US and European countries and there is a lesser attention relevant to developing countries (Gompers et al., 2008). Due to different national contexts of board's operation in two developing countries of Iran and Malaysia nearly there is no literature which considers and compares the impact of corporate governance on firm performance in these countries. Therefore, the goal of present study is to identify the impact of four variables of corporate governance; percentages of directors' ownership, board size, percentages of independent non-executive directors and Independent chairman on corporate performance in Iran and Malaysia. These two countries have been selected because they differ substantially from institutional perspective

2. Literature Review

The financial crisis of 1997 changed the landscape of corporate governance essentially. Iran and Malaysia weren't except from this crisis. As mentioned, there is a significant different national context of board's operation in these countries. Iran has especial environment characteristics like strict Islamic regulation. Therefore, its business and social activities is based on fundamentalist religious laws and regulations. The process of board selection in Iranian companies' emphasis more on officers' faith and Islamic Shariah Law. This emphasis is different from Malaysian companies where almost the selection of boards is based on educational level, specialization, and political affiliation. Moreover of religion role that has significant impact on corporate governance in Iran, the other significant factor is Iranian civil law. LaPorta *et al* (1998) mentioned that Iranian civil law influences corporate governance significantly, they believe that for creditors and shareholders' it could prepare fairly weak legal protection and leads to dispersion of company ownership and finally lesser financial statement transparency. Therefore, the present study examined the impact of four variables of corporate governance on corporate performance in Iran and Malaysia.

From agency theory perspective, the existence of non-executive directors in board and their monitoring role as an independent director decreases the conflict of interest between shareholders and managers. Non-executive directors with professional and impartial point of view will sit to judge about managers' decisions (Marrakchi, et al, 2004). In a study, Hsueh (2010) examined the association between board characteristics and financial performance (Q ratio) among 223 American companies. The results indicated that there is a negative relationship between non-executive directors of the board and a positive relationship between the quality of the board and financial performance of a company. Moreover, he did not find any significant associations between percentage of director's ownership and financial performance. The lack of CEO presence in position of chairman at the board's of a company plays an important role in the effectiveness of board of directors' performance (OECD, 1998).Empirical analyses of the effect of CEO duality on different measurement of corporate governance created various consequences. For example, Boyd (1994) reported that CEO duality had positive impacts on better performance of the US firms. But Rhoades et al. (2001) reported that companies with separation role of chairman and CEO compared with companies with CEO duality had higher level of accounting returns. Harasheh, et al, (2010) investigated the impact of institutional investors on the performance of listed companies in Palestine stock exchange. They considered Tobin's Q as a proxy of performance. The results of regression analysis showed that there was a significant positive relationship between percentages of institutional investors and Tobin's Q in 2005, but there was no relationship in 2007 and there was a negative relationship between them in 2006 and 2008. On the other hand, Larcker *et al* (2010) examined the impact of institutional investors on stock performance of American listed companies between 2007 and 2009 in the wake of recent actions related to corporate governance rules in America. The research results indicated that institutional investors had a positive impact on the performance of these companies. Similarly, Kapopoulos and Lazaretou (2007) investigated the effect of ownership structure on firm's performance by using the data from 175 Greek companies. They reported that the centralized ownership structure was associated positively with higher profitability of a company and lesser dispersion of ownership could lead to higher profitability. Garay and Maximiliano (2008) examined the relationship between corporate governance and corporate performance measures, like: earning per share, P/E, ratio of market to book value and Tobin's Q in Venezuelan stock market. The results showed that the percentage increase in the corporate governance index leads to 3.11 percentages increase in earnings per share, 9.9 percentages in P/E and 7.2 percentages in Tobin's Q.

The leverage ratio outcomes of empirical studies indicated conflicting consequences. John and Senbet (1996) stated that the existence of leverage in corporations may reduce external capital's cost and leads to improvement of managerial performance. They also believed that debt have a positive disciplinary impact on firm's performance. However, Weir and Laing (2001) stated that there is a significant negative relation between leverage and performance. Amman et al. (2011) investigated the relationship between corporate governance and firm value; it consisted of 6663 observations of 22 developed countries over the period of 2003 to 2007.The results showed a strong positive relationship between corporate governance and value of companies. Bonn et al. (2004) made a comparison between the effects of board structure and corporate performance in Japan and Australia. They discovered board size and board's members' age negatively associated with Japanese and Australian companies. Moreover, in Australian firms, non-executive directors and women directors have positive relationship with firm's performance. Ponnu (2008) examined the structure of corporate governance and firm's performance in Malaysian companies. The result indicated that there was no significant

relationship between corporate governance and firm performance. Oconnell and Cramer (2010) investigated the relationship between board characteristics and performance of Ireland listed companies. They found significant negative relationship between firm size and firm performance.

3. Hypothesis

To examine the impact of corporate governance mechanisms on the performance of companies listed on Tehran stock Exchange and Bursa Malaysia, the main hypothesis and four sub-hypotheses are designed as follow:

3.1. Main hypothesis

There is a significant relationship between corporate governance mechanisms and firm performance.

3.2. Sub-hypotheses

H1: There is a significant relationship between the percentages of director's ownership and firm performance.

H2: There is a significant relationship between the board size and firm performance.

H3: There is a significant relationship between the percentage of non-executives and firm performance.

H4: There is a significant relationship between the role of CEO duality and firm performance.

4. Data Collection

This study is a practical research. The research design is a quasi-experimental based on secondary data. The figures are based on research data, actual data of stock market and corporate financial statements. For collecting Iranian companies' data, library research method is used. Data are taken from Persian and Latin books, magazines and also required to go through the financial statements and explanatory notes. Moreover, for collecting Malaysian data the annual reports of Malaysian companies were taken from Bursa Malaysia website.

5. Population and Sample

Time frame of this study is about five years, from 2006 to 2010. The population of study comprised of all companies listed on Tehran Stock Exchange and 96 companies listed on Bursa Malaysia. The selections of companies were based on the availability of the period leading up to the end of their fiscal year. Moreover, due to the specific nature of activities, companies shouldn't be as a component of industry, investment banks or financial institutions. In addition, during the period of study, financial year shouldn't have any changes and all the required non-financial and financial information should be available. The sample size of this study is totally 138 companies selected from Iranian and Malaysian company during five years.

6. Research variables

The regression model used in this research is as follow:

$$\begin{aligned} Q\,TOBIN_{it} = {} & \beta + \beta_1(PERDIRSHARE)_{it} \\ & + \beta_2(BSIZE)_{it} \\ & + \beta_3(PERINBOARD)_{it} \\ & + \beta_4(CEO)_{it} + \beta_5(LEVERAGE)_{it} \\ & + \beta_6(SIZEFRIM)_{it} + \varepsilon_i \end{aligned}$$

6.1. Dependent Variable

Previous studies for the connection of corporate governance to firm performance have used different proxies of firm valuation such as EPS, ROA, ROE, RET e.g., Hermalin and Weisbach (2003); Shleifer andvishny (1997) and John, K., & Senbet, L. (1996). In this research Tobin's Q is considered as dependant variable and as a proxy for measuring firm performance. That is as fallow:

Q TOBIN= (Market value of stock owners' rights +Book value of debts) / (Total book value of assets)

6.2. Independent Variable

Four independent variables of present study are as follow:

Director's ownership: This is the percentage of shares hold by board's directors

The number of board members: This is the number of members in board of a corporation

Percentages of non-executive director: this is the ratio of non-executive director to total board director.

Independency of CEO from chairman: It is a dummy variable. Coded '1' if CEO also holds the position of board chair or '0' if both positions are separate.

6.3. Control Variables

Two variables are used as control variables in this research which are:

Financial Leverage: Ratio of total debt to total assets.

Firm Size: Is the natural logarithm of total assets of a company.

7. Analysis and Findings

There are some assumptions for linear regression analysis. The minimum distance of scale measurement, normal distribution of variables, the existence of linear relationship between dependent and independent variables, equality of residual dispersion, equality of variable's variance, and lack of correlation are some assumptions for using regression analysis. In present study, scale measurements of variables are based on ratio and there is a linear relationship between dependent and independent variables. To investigate the linear relationship between variables, coefficient correlation is used. Finally, for indentifying the impact of independent variables on dependent variables, the multiple regression analysis in EVIEWS 7 software is used.

7.1. Test of Heteroscedasticity

For examining the existence of heteroscedasticity of disturbing statements, ARCH-LM test for both countries is done. The result of this test is described in Table 1.

Table 1: Heteroskedasticity Test: ARCH-LM

	Malaysian companies	Iranian companies	Total companies
F-statistic	* 842.9059	1.024626	*50.39936
Obs*R-squared	* 305.8945	1.026934	*47.86476

* 1% error level

According to the statistics, the results of both tests in Malaysian companies and Iranian companies are significant at 5%, so the assumption of homogeneity of variance is rejected and the Heteroscedasticity of disturbing statements are accepted. This issue is caused by defect assumption of $Var\ (U_i) = \delta^2 I$ .Such problem in regression will cause the results of OLS regression not to be efficient anymore. Therefore, to solve this problem, the method of generalized least squares (GLS) should be used.

7.2. Test of Autocorrelation

In order to test the lack of autocorrelation in present model, the statistic of Durbin–Watson is used. Based on the findings of Table 2, 3 and 4 these statistics are 2.27, 1.95 and 1.72, respectively. If these statistics are placed in 1.5 to 2.5 ranges, the H0 of test is accepted. It means that there is a lack of correlation between the residuals. Otherwise, H0 will be rejected and it means that it is possible to accept the existence of correlation between the residuals. Therefore, based on the present statistic it's acceptable that there is not any positive and negative correlation in this model.

7.3. Test of Hypotheses

Three forms of multiple regression analysis are done as follow.

7.3.1. Companies listed on Tehran Stock Exchange

Hypothesis test is done to examine the significant relationship between corporate governance and corporate performance in companies listed on Tehran Stock market. According to the given method of study to estimate the model, multiple regression of fixed effects method is used. For testing the significance of Independent variable's coefficients, (T-statistic) test is applied. Moreover, to test simultaneous coefficients significance of all variables for explaining the dependent variable, (F statistic) test is used. According to the results of main model test as described in Table 2, it can be seen that P-Value of F-statistic means the significance of whole regression is equal to 0.0000 .This indicates that the model is significant at (0.99%) level. Adjusted R2 is equal to 0.55 which implies that approximately 0.55% of changes in dependant variable can be explained with model's variables.

Table 2 : Results of multiple regression analysis of Iranian companies

Dependent. V: proportion of Tobin's Q			
$Q\ TOBIN_{it} = \beta + \beta_1(PERDIRSHARE)_{it} + \beta_2(BSIZE)_{it} + \beta_3(PERINBOARD)_{it} + \beta_4(CEO)_{it} + \beta_5(LEVERAGE)_{it} + \beta_7(SIZEFRIM)_{it} + \varepsilon_i$			
Independent. V	Coefficient	t-Statistic	P-value
C	22.065	10.492	0.000
PERDIRSH	-0.007	-0.182	0.855
BSIZE	-0.171	-1.075	0.283
PERINDIR	0.003	0.333	0.738
CEOD	0.147	0.239	0.811
Control .V			
LEVERAGE	0.003	0.183	0.854
FIRMSIZE	-3.512	-10.648	0.000
Adjusted R2	0.55%	P-value	0.000
F-Statistic	6.781	Durbin Watson	2.27
Panel Tests			
	Test Statistic	Test Significant	
Augmented F test	7.12	0.0000	
Hausman test	97.09	0.0000	

Where: PERDIRSH: Percentages of director's ownership, BSIZE: Number of board member, PERINDIR: Percentages of independent directors, CEOD: Independency of CEO from chairman, LEVERAGE: leverage ratio, FIRMSIZE: Firm size.

As can be seen in Table 2, except firm size, none of the independent variables at 0.05% level of error has shown any significant relationship with Tobin's Q proportion. So, it can be stated that there is not any significant relationship between company's corporate governance and Tobin's Q among accepted companies listed on Tehran Stock Exchange.

7.3.2. Companies listed on Bursa Malaysia

Hypothesis test is done to examine the relationship between corporate governance with corporate performance of companies listed on Bursa Malaysia. To estimate the model, the combination regression method of fixed effects is used. As previously mentioned, (T-statistic) and (F statistic) test are used.

Based on the results of the model test in Table 3, it can be seen that P-Value of F-statistic is 0.0000, and this indicates that the model is significant at 0.99% level. Adjusted R^2 is 0.91 which implies that approximately 0.91% of changes in dependant variable can be explained with model's variable.

Table 3: Results of regression analysis the combination of Malaysian companies

Dependent. V: proportion of Tobin's Q			
$Q\ TOBIN_{it} = \beta + \beta_1(PERDIRSHARE)_{it} + \beta_2(BSIZE)_{it} + \beta_3(PERINBOARD)_{it} + \beta_4(CEO)_{it} + \beta_5(LEVERAGE)_{it} + \beta_7(SIZEFRIM)_{it} + \varepsilon_i$			
Independent. V	Coefficient	t-Statistic	P-value
C	9.957	30.368	0.000
PERDIRSH	-0.003	-2.357	0.018
BSIZE	0.008	1.340	0.180
PERINDIR	-0.010	-0.512	0.608
CEOD	-0.187	-1.834	0.067
Control .V			
LEVERAGE	-0.536	-9.300	0.000
FIRMSIZE	-0.222	-3.148	0.010
Adjusted R2	0.91%	P-value	0.000
F-Statistic	47.277	Durbin Watson	1.95
Panel Tests			
	Test Statistic	Meaningfulness of Test	
Augmented F test	37.82	0.0000	
Hausman test	90.24	0.0000	

Where: PERDIRSH: Percentages of director's ownership, BSIZE: Number of board member, PERINDIR: Percentages of independent directors, CEOD: Independency of CEO from chairman, LEVERAGE: leverage ratio, FIRMSIZE: Firm size.

As can be seen at Table 3 at 5% error level, the percentages of director ownership with coefficient of -0.003 have significant negative relationship with Tobin's Q in Malaysian companies. Moreover, Independency of CEO from chairman at 10% error level with coefficient of -0.187 also has significant negative relationship with Tobin's Q. But the other independent variables didn't show any significant relationship with Tobin Q. In the case of control variables both leverage ratio and firm size have shown a significant negative association with firm performance.

7.3.3 Companies listed on Tehran Stock Exchange and Bursa Malaysia

Hypothesis test examined the relationship between corporate governance with corporate performance of companies listed on Tehran Stock Exchange and Bursa Malaysia. To estimate the model based on compound regression, the fixed effects method is used. In addition, (T-statistic) and (F statistic) as mentioned above are applied. According to finding of Table 4, the P-Value of F-statistic is 0.0000. This indicates that the model is significant at 0.99% level. Adjusted R^2 is 0.89 which means that about 0.89% of changes in dependant variable can be explained with model's independent variables.

Where: PERDIRSH: Percentages of director's ownership, BSIZE: Number of board member, PERINDIR: Percentages of independent directors, CEOD: Independency of CEO from chairman, LEVERAGE: leverage ratio, FIRMSIZE: Firm size.

Table 4: Result of regression analysis, the combination between Iranian and Malaysian companies.

Dependent. V: proportion of Tobin's Q			
$Q\ TOBIN_{it} = \beta + \beta_1(PERDIRSHARE)_{it} + \beta_2(BSIZE)_{it} + \beta_3(PERINBOARD)_{it} + \beta_4(CEO)_{it} + \beta_5(LEVERAGE)_{it} + \beta_7(SIZEFRIM)_{it} + \varepsilon_i$			
Independent. V	Coefficient	t-Statistic	P-value
PERDIRSH	-0.001	-1.855	0.063
BSIZE	0.014	2.938	0.003
PERINDIR	0.004	1.148	0.251
CEOD	-0.038	-0.459	0.645
Control .V			
LEVERAGE	0.0006	0.159	0.873
FIRMSIZE	-1.569	-27.48	0.000
Adjusted R2	0.89%	P-value	0.000
F-Statistic	40.71	Durbin Watson	1.72
Panel Tests			
	Test Statistic	Meaningfulness of Test	
Augmented F test	39.61	0.0000	
Hausman test	99.57	0.0000	

As it shown in Table 4, the independent variable of percentages of director ownership has a significant negative relationship with the proportion of Tobin's Q at the level of 10% error. This means that the percentages of director ownership, with coefficient of -0.001 have a significant negative relationship with corporate performance in both countries. In addition, board size at 5% error level and coefficient of 0.014 has a significant positive relationship with proportion of Tobin's Q in companies. But other independent variables didn't show any significant relationship with corporation performance.Considering the control variables in both countries, only firm size has shown a significant negative association with Tobin Q.

8. Conclusions

The main objective of this study was to make a comparison between the relation of corporate governance and corporate performance of Iranian and Malaysian companies. In this regard, by considering some corporate governance variables and using hybrid model, it was tried to investigate the effect of these variables on corporate performance. As a result of testing four hypotheses in three sections, these findings are discovered which are as follows.

In the case of first hypothesis test which is related to examining the relationship between the percentages of director's ownership and corporate performance, the results indicate that there is not any significant relationship between this variable and performance of corporations in Iranian companies. But there is a significant negative relationship between this variable and corporate performance in Malaysian and total companies (combination of Iranian and Malaysian companies).It means that the higher percentages of director's ownership may lead to lesser performance of companies. As mentioned in the literature, this finding is congruent with findings of Harasheh, et al, (2010) in Palestinian companies who has found a negative relationship between institutional investors and Tobin's Q in 2006 and 2008. Examining the second hypothesis, the relationship between the board size and firm performance shows that there is not any significant relationship between these two variables in Malaysian and Iranian companies separately, but in total form there is a significant positive relationship between board size and corporation's performance. This finding is consisted with the findings of Singh and Harianto (1989) who believed that the larger the board size, the better the performance of companies would be. The results of examining third hypothesis which is about the relationship between the percentage of non-executive directors and corporate performance indicated that there is not any significant relationship between these variables in Malaysian and Iranian companies in both forms separately or totally.

In the case of forth hypothesis test, which is about the relationship between the role of CEO duality and corporate performance the results showed that there is not any relationship in Iranian or total companies. But in Malaysian companies there is a significant negative association between these variables. It means that the existence of the role of CEO's duality may decrease Malaysian companies' performance. This finding is in agreement with statement of Malaysian Code of Corporate Governance (MCCG), which suggested that it is better to have separated role of CEO and chairman to make sure accurate

balance and checks of the top management of the firms. The results of control variable indicate that there is a significant negative relationship between firm size and corporate performance in Iranian and total companies. Although, not only there is a significant negative relationship between firm size and corporate performance in Malaysian companies but also there is a significant negative association with other control variables, leverage ratio and corporate performance in Malaysian companies. As mentioned in the literature, this finding is similar to the results of Oconnell and Cramer (2010) in Ireland.

Therefore, based on the findings of this study, some of the corporate governance variables have significant impact on firm's corporate performance, so by the investigation of these variables managers can improve the performance of their corporations. Future research studies should consider and compare the other characteristics of corporate governance on corporate performance in other countries. In addition, they can investigate another proxy of performance such as, EVA, return on investment, market to book ratio or accounting performance like ROE and ROA. For The researchers who are interested to do research on this area, the suggestion is that it is better to consider various industries or manufacturing companies because the researcher's type of industry may have essential influence on research result.

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