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The Role of Board Governance in Alleviating Corporate Expropriation in Malaysia

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Abstract: Based on the agency theory, this study is conducted to investigate the influence of the firms' board governance on corporate expropriation. This study makes use of board structure, board diversity and board remuneration as proxies for board governance. The findings indicate that all board governance mechanisms have significant relationships with corporate expropriation in Malaysia. The results signify that board governance mechanisms play a role in dealing with corporate expropriation in Malaysia.

JEL Classification: G32,G34, G35
Key words: Corporate Governance · Board Diversity · Payout Policy · Expropriation

INTRODUCTION

Financial crisis in 1998 witnessed that Malaysia needed to strengthen its corporate governance which resulted to the establishment of the High Level Finance Committee on Corporate Governance. In its March 1999 report, the Committee revealed that the massive loss of confidence by investor in Malaysia's capital market was due to the cases of corporate abuse including expropriation and conflict of interest. Generally, expropriation is defined as the method of using ones' control power to capitalize on for their best interest and redistributes wealth from other shareholders to themselves. Corporate expropriation is made possible by ineffective enforcement and presence of large shareholders who can influence the control of the firm. This is consistent with the description given by Shleifer & Vishny [1] and Sulong and Mat Nor [2] that expropriation related with an illegal removal of asset, wealth and profit especially by controlling shareholder using their power of control in the firm at the expense of other shareholders for their own benefit

The nature of listed firm where the management of the firm is separated from its ownership has resultedthe management in the hand of board of directors. Board of director plays an important role to lead the company and to ensure that its main responsibility is well executed. The role played by the board is very important in determining the corporate policies and the strategic direction for the company to ensure that the interests of shareholders are protected. As such, board heterogeneity should be promoted and effective monitoring needs to be in place to enhance boardroom discussion and promote quality governance which will eventually reduces the possibility of expropriation. Unlike the earlier studies that connected the role of directors and firm's performance, this study is distinguished by specifying the role of board governance in alleviating corporate expropriation in Malaysia.

Literature Review

Agency Theory: According to Berle and Means [3], agency theory discusses the relationship between principal and agent. It is existed when the principal authorized the agent to represent him/her with certain pre-determined conditions. However, misalignment of interest arises due to differences in the perception of risk leading to differences in action, decision making and goal of both parties. As a result, the principal has to incur cost to monitor the agent so that the agent acts according the requirement set forth by the principal. Notably, the board

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of directors is the highest governing authority in the management structure of a public listed company. The top management usually serves as a corporate officer who is responsible to manage the corporation in the best interest of the shareholders. The question here is does the top management act in the best interest of the shareholders? Naturally, top management is more concerned with its own objective rather than the interest of the shareholders. This will lead to a conflict of interest between the top management and the shareholders.

Board Governance and Expropriation: The role of board of directors is very important to ensure that the running of company is in the best interest of the shareholders. La Porta *et al*. [4] conducted an extensive analysis pertaining to the investor's protection and corporate governance, in light of the fact that many large companies worldwide are dominated by large shareholders that allow them to control the firm. Therefore, the companies are vulnerable to expropriation of wealth by controlling or large shareholders due to the power that they have in controlling the firm.

The manager's role and the role of monitoring by the board of directors are crucial in determining the financial policies of a company as evidenced by Richardson *et al*. [5]. According to Jaskiewics and Klien [6], the size and composition of the board of directors could affect the decision making process and the overall efficiency of the board of directors due to their role that represents the group's decision making in order to reduce the agency conflict of the firm. La Porta *et al*. [4] suggested that there should be a positive relationship between corporate governance quality and dividend payout because firms with better governance will ensure the best protection for their shareholders. Thus, shareholders have the power to pressure the management to distribute higher dividends rather than letting the excess cash to be expropriated for their private benefits [4,7]. Several previous studies proposed that dividends are used as a tool to shrink the agency costs of free cash flow as well as to protect shareholders from expropriation [8].

In the light of the above discussion, the linkage between corporate governance and vulnerability towards expropriation will address the relationship between the board governance and the expropriation of shareholders.

Hypothesis Development

Board Structure

Board Size: There are advantages and disadvantages of a large or a small board size. However the presence of a large board size seems to be less effective in decision making. Previous studies such as Lipton and Lorch [9], Belkhir [10] and Hermalin and Weisbach [11] documented that a large board size contributed to a slow or a weak decision making, such as delay in making decision and poor decision. This is due to disagreement between members, communication problem and time consuming in large board size.

However, small board size will result in arbitrary and subjectivism in decision making as well as self-interest behaviors by the controlling shareholders through proxy by insider director. Raheja [12] pointed out that firm has larger board size when the level of expropriation is high. Large board size seems to be better for firms in a situation where the firm is vulnerable to corporate expropriation by controlling shareholder. According to Chen *et al*. [13] large board size should be able to control agency conflict efficiently due to resource advantage that provides cross-industry management, help to create good external image and present various interests to avoid cronyism.

From the perspective of financial decision, board size has an influence on dividend policy. According to Agrawal and Nasser [14] and Chen *et al*. [13], firms with large board size recorded higher dividend yield and firms with the presence of large board size were more likely to pay high dividend. It can be argued that the tendency of firms with to pay high dividend is associated with corporate expropriation by the controlling shareholders through their proxy sitting on the board. To prevent the board of director from being dominated by insider directors who represent the controlling shareholders, Chen *et al.* [13] recommended that firms should have a large board size. Hence, board size is expected to have a positive relationship with dividend payout in order to avoid expropriation of wealth by controlling shareholder.

According to Wen *et al*. [15], Abor [16] and Graham *et al*. [17], firms with large board size are expected to pay high dividend due to more efficient monitoring role that can be carried out. In addition, large board size with vast experience and knowledge and wide range of perspectives would minimize the vulnerability towards corporate expropriation [18]. Based on the above arguments, board size is expected to have an impact on corporate expropriation through dividend payout. For this study, it is hypothesized that:

H1a: There is a positive relationship between large board size and dividend payout.

Board Independence: The presence of independent director is expected to reduce the agency conflict in the firm by carrying out their role in protecting the interest of minority shareholders [19, 20]. They are also expected to contribute some professional judgments [20] and to avoid the decision made being influenced or dominated by a certain group of individual especially, inside directors who represent the controlling shareholders that will expropriate other shareholders [5,21,22]. Besides that, the presence of many independent directors will have some impact on performance of the company [5,19,23].

The presence of independent director may also influence the corporate policies [6, 24, 25] and will reduce the agency problem. Previous study found that the presence of independent could have an impact on the dividend policy [24, 26]. Agrawal and Nasser [14] and Chen *et al*. [13] revealed that the presence of many independent directors in the firm would more likely result to a higher dividend to the shareholders. It will also reduce the domination of insider board [21, 22] and thus reduces the probability of expropriation of wealth [23].

In the light of the above, firm with more independent directors is expected to pay a higher dividend due to rigorous monitoring role that reduces the firm's vulnerability to corporate expropriation. Therefore, the hypothesis is formed as follow:

H1b: There is a positive relationship between independent board and dividend payout

Board Diversity

Woman Director: Prior studies recommended that diverse board increases board independence [27]. It also served as effective monitoring device thereby making financial report more transparent and reliable [28]. Thus, it would affect the decision making process and eventually improve firm's performance [29]. Past studies on gender postulated that there was a positive relationship between woman on board and firm's performance [27,30,31,32]. Previous studies also documented that inclusion of woman as director would enhance the independence of the board [33]. Presence of woman on board would contribute to enhance the quality of governance in boardroom by providing different point of view in discussion and make a board more interactive [34, 35]. Women are more concentrated on their role by avoiding political behavior that enhance the efficiency of board [36] and thus would enhance their monitoring role [31]. Therefore, women as board member would bring a lot of benefits to the shareholder and seem to alleviate the vulnerability of firm's towards corporate expropriation. It is hypothesized that:

H2a: There is a positive relationship between women on board and dividend payout

Foreign Director: Another dimension of board diversity is nationality of the board of director. The presence of foreign board improved firm's performance due to monitoring function that they carried out. They alsomake the board to be more independent thus reducing expropriation and restrict the power of existing board members [37, 38]. Moreover foreign board member also brings diverse opinion and views, professional experiences and different thinking and heterogeneity [39, 40]. Therefore, presence of foreign board member would also enhance the role of board of director in dealing with the vulnerability of firms towards corporate expropriation.

H2b: There is a positive relationship between foreign board and dividend payout

Tenure of Independent Board: According to Vafeas [41], director tenure is one of determinant of director quality Longer board tenure makes the mature and will influence decision making [42]. Director with long tenure would provide them with vast experience and thus better in directing the policies of the firm [41, 43, 44]. It also enhances the effectiveness of the monitoring especially on financial reporting [45]. In consideration of the benefit of board tenure that brings to the boardroom, it is more likely that board tenure will contribute to enhance the quality of governance that leads to lower the vulnerability towards corporate expropriation. Thus, the following hypothesis is developed:

H2c: There is a positive relationship between board tenure and dividend payout

Board Remuneration: Attractive remuneration scheme is believed to motivate and retain the board of director's quality for the benefit of shareholders and firms. A study by Yatim [46] proved that there was a significant and positive relationship between director's remuneration and performance of listed companies in Malaysia. In addition, the higher payment to directors wasdue to their higher ownership in that firm as evidenced by Basu *et al*. [47] in a study involving Japanese firms. Moreover, there was a positive relationship between family ownership and remuneration for German Listed companies [48]. There was also a positive association between managerial ownership and cash emoluments for Hong Kong listed firms [49]. In relation with dividend, remuneration should motivate the directors to perform their function in realizing dividend to maximize shareholders wealth. According to Ruparelia and Njuguna [50], a positive and significant relationship would mean that the directors are playing an effective role of maximizing shareholder's wealth. As the shareholders wealth is maximized, it would be translated into low expropriation. Therefore, the following hypothesis is developing:

H3: There is a positive relationship between board remuneration and dividend payout.

METHODOLOGY

Data Collection: This study covers non-financial firms listed on the Main Market (focuses on firms listed on the Main Board previously) of Bursa Malaysia. In addition, it excludes all finance-related companies, banks, insurance, unit trusts and utilities companies due to their differences in regulatory requirements, financial reporting standards and compliances [51,52,53]. Moreover, the study excludes companies that are listed under distressed companies (PN4 Companies). It is important to note that the announcement of implementation of Malaysian Code of Corporate Governance (MCCG) through the amendments of Bursa Malaysia Listing Requirement was made in January 2001. The amended MCCG in 2007 has a significant impact on the existing structure of corporate governance. Therefore, the analysis of this study will cover the period from 2008 to 2012. Even though another round of amendment was made with the release of MCCG 2012, the selection of variables in this study is not affected by the changes proposed by the newer version of MCCG.

The data of this study which consist of data for ownership structure is obtained from company annual reports. The websites of Bursa Malaysia and OSIRIS financial database become the main source for data related to this study. The individual company annual reports are downloaded from the Bursa Malaysia website, while financial data such as asset, growth rate and profitability are obtained from the OSIRIS financial database.

Dependent Variable: This study intends to determine the impact board governance on corporate expropriation. There are several past studies that have employed dividend payout as a measure of dividend policy such as Facio *et al*. [54], Thomsen [55], Cronqvist & Fahlenbrach [53] and Ghachem [56]. Therefore, this study defines corporate expropriation based on Dividend/Earnings ratio where earnings are measured as after taxes and interest but before extraordinary items.

Independent Variables

Board Structure

Board Size (SIZE): This study makes use of the total number of directors on the board to measures the size of board of directors. The presence of small or large board size is important in influencing the effectiveness of the board in making decisions for the company. A number of previous studies have used the total number of directors on the board to measure the board size of the company [1,57,58].

Board Independence (INDP): Independent directors refer to directors who have no relationship with management such as employee or large shareholders in the firm that will represent the interest of all shareholders in the firm. This study employs board independence that refers to the proportion of independent directors over total number of directors on the board. There are several past studies that also employed total numbers of independent directors on the board as proxy for independent board such as Brickley *et al.* [19], Richardson [5], Y.C. Tu [57], Ponnu [23], Sulong [5] and Chen [13].

Board Diversity

Woman Director (FEMP): Proportion of women on the board has been employed to measure woman on the board (FEMP). This measure was commonly used in prior research [34, 35, 28]. More women on the board will bring up significant change in the boardroom due to their talent but not because gender issue that lead to enhance governance quality [34, 30].

Foreign Director (FORP): To measure foreign board (FB), this study uses the number of foreign director sit on the board against the total number of directors that has been widely used by prior studies [35,38,39,59]. Foreign director will help to reduce expropriation as they are seen to be more independent and believed to enhance corporate governance practices in the firm.

Tenure of Independent Director (TENP): The tenure of independent directors is measured by the percentage of independent directors whose tenure is equalor greater than 8 years. This measurement is used in board independence studies by Vafeas [41] and Sharma [60]. It reflects the likelihood of longer tenure independent directors will reinforce independent directors' with more power to discipline the management with more confident and with tendency to challenge management when necessary.

Board Remuneration (LREM): In this study, total cash director remuneration is used to measure the board remuneration for executive and non-executive directors which consists of fees, salary bonus and benefit of kin. Many previous studies employed cash remuneration as a proxy for director's remuneration [61,47,49].

Control Variables

Firm Size (FS): It was indicated in the earlier study, that the size of the firm affected dividend policy. As argued by Sulong and Mat Nor [1], larger companies have better growth opportunities and access to financing opportunities. In effect, larger firms will have better earnings and higher dividend payout. According to Chu [62], a large size firm with many shareholders in dispersed ownership structure was better in its risk sharing. Moreover, a large firm enjoyed economies of scale and scope and incurred a larger scale of debt capital. In overall, the effect is that larger firms will have better earnings and higher dividend payout. In addition, Frank and Goyal [63] pointed out that large firm increased its debt in order to finance dividend payment. Consistent with the earlier study, logarithm of corporation's total assets is employed as a proxy of the firm's size.

Firm Growth (GWT): The inclusion of firm's growth in influencing corporate financial policies is due to the fact that growth is an indicator of the firm's success and profitability [64]. A high growth firm is generating better earnings and is expected to pay high dividend. In relation to Malaysian firms, Pandey [65] argued that firm's earning was an important determinant in dividend payout in Malaysia. It is also supported by Aivazian *et al*. [66] who found that profitability had a significant effect on dividend payout. Based on the above mentioned arguments, it is important that the different growth prospect of the firm to be controlled in this study. In doing that, the annual percentage change in total asset is employed as a proxy for the firm growth.

Profitability (PFT): There were a number of previous study which examined the effect of profitability on the firm's corporate financial policies such as Friend and Lang [67], Brailsford *et al.* [64] and Sulong and Mat Nor [1]. The level of the firm's profitability would determine the amount of dividend payout. Following Moh'd, Perry and Rimbery [68] and Brailsford *et al.* [64], operating income to total asset is employed as a proxy for profitability.

Model Specification: This model intends to test whether board governance have significant impact on corporate expropriation as proxy by dividend payout. Using panel regression method, the model specifications are presented as follows:

$$Y_{it} = \beta_0+\beta_1 SIZE_{it}+\beta_2 INDP_{it}+\beta_3 FEMP_{it}+\beta_4 FORP_{it}+\beta_5 TENP_{it} +\beta_6 LREM_{it}+\beta_7 LFS_{it}+\beta_8 GWT_{it}+\beta_9 PFt_{it}+\varepsilon_{it}$$

where:

Y_{it}	Dividend payout ratio measured by the dividend to earnings ratio. Earnings are measured as after taxes and interest but before extraordinary items.
β_0	The constant term or intercept across sectional observations
SIZE	Total number of director on the board
INDP	Total number of independent director on the board
FEMP	Percentage of women director on the board
FORP	Percentage of foreign director on the board
TENP	Percentage of independent director whose tenure are greater than or equal to 8 years
LREM	Log of total cash director remuneration which consists of fees, salary bonus and benefit of kin
LFS	log of firm's total asset
GWT	Percentage change of firm's total asset
Pft	Operating income to total asset
ε_{it}	The error term

RESULTS AND DISCUSSIONS

Descriptive Statistics: Table 1 presents the descriptive statistics for all variables. In terms of dividend, public listed companies in Malaysia use an average of 21 percent of their earnings to pay dividend. There are about eight directors with a minimum of four and up to a maximum of 14 in the Malaysian companies. On the other hand, independent board members constitute 43 percent of total board members in each firm with a maximum of 83 percent. The percentage of independent directors in this study is in compliance with the requirement stated in Bursa Malaysia listing requirement which is at least 33%. Female directors form 9.25 percent while foreign director comprises 4 percent of the total board members in each of public listed companies in Malaysia. It is also found that the average operating income to total assets is around 6 percent while firm's growth rate averaged at 7.67 percent. The mean percentage of board of director that serve more than 8 years (TENP) is between 41% which means that less than 50% of the director served more than 8 years on the board. The total remuneration (REM) range from RM0.59 million to RM592.6 million with the mean and median values is between RM3.8 million to RM8.9 million and between RM2.2 million to RM4.2 million respectively. The descriptive statistic table also shows the profitability (PFT), growth (GWT) and total asset (FS) of the overall sample and sub sample. The average of profitability, growth and total asset are 6%, 7.67% and RM451 million respectively.

Table 1: Descriptive Statistics

	Mean	Med	Maxi	Min	Std. Dev.	J-Bera	Prob
DIVE	0.2096	0.1627	0.9196	0.0000	0.22	222.81	0.0000
SIZE	7.7669	7.0000	14.0000	4.0000	1.96	105.95	0.0000
INDP	0.4284	0.4286	0.8333	0.0000	0.11	85.095	0.0000
FEMP	0.0925	0.0000	0.6000	0.0000	0.11	413.58	0.0000
FORP	0.0407	0.0000	0.6000	0.0000	0.09	5461.9	0.0000
TENP	0.4606	0.5000	1.0000	0.0000	0.32	96.534	0.0000
LREM	7.8552	7.7892	11.6758	4.0775	0.99	103.01	0.0000
LFS	13.2680	13.1054	17.7595	9.8477	1.20	288.92	0.0000
GWT	0.0767	0.0484	1.7997	-0.9559	0.19	21003.	0.0000
PFT	0.0597	0.0539	0.9406	-0.3558	0.08	6461.99	0.0000

Notes: DIVE = Dividend over earning; SIZE = Number of Board of Director; FEMP = % Female on Board; FORP = % Foreign on Board; INDP = % Independent Board; TENP = % Tenure of Board of Director serves more than 8 years; REM = total remuneration; PFT = profitability; GWT = % of growth of the company;FS = total asset

Regression Result: The results for panel regression of board governance on corporate expropriation is presented in Table 2.

Board Structure

Board Size: The results show that there is significant relationship between board size and dividend payout. Thus, hypothesis H1a is accepted. This finding suggest large board size have greater tendency to distribute dividend to the shareholders. It is also consistent with Agrawal and Nasser [14] and Chen *et al*. [13] that firms with large board size recorded higher dividend.Therefore, findings from this study signify that large board size is functioning well as internal governance control mechanisms in Malaysian PLC. Consequently, the presence of large board size in the firms could lessen the agency problem and hence alleviates corporate expropriation.

Table 2: Panel Regression Results

Independent variable	Expected Signs	Coefficients (N=1373)
Constant	?	0.101***
SIZE	+	0.004***
INDP	+	-0.068***
FEMP	+	-0.125***
FORP	+	0.074***
TENP	+	0.024***
LREM	+	0.012***
PFT	?	0.243***
GWT	?	-0.029**
LFS	?	0.002
R-squared		0.915
Adjusted R-squared		0.892
F-statistic		38.407
Hausman Test		56.919***
Durbin-Watson stat		2.003

***Significance level at p <0.01; **Significance level at p <0.05; *Significance level at p <0.10

Independent Board: This study indicates that board independence is negatively influenced dividend payout of listed companies in Malaysia. The finding of this study demonstrates that independent board is performing against their role as a monitoring device in the firms. According to Abdul Samad [69], Ishak and Napier [70] and Zuha *et al*. [71], the reason why the independent board ineffective in performing their task is possibly due to the nature of Malaysian firms which are highly concentrated and controlled by a few shareholders. Shleifer and Vishny [2] commented that the presence of controlling shareholders in highly concentrated ownership structure would result in expropriation by controlling shareholder. Controlling shareholder could use their power to decide on the members of board of directors and hence it makes independent directors ineffective to play their role as internal governance control mechanisms as suggested by Allen *et al*. [72]. In addition, the implementation good governance structure proposed by MCCG is only on appearance because of the enforcement is still ineffective as stated by Mohamed Yunos *et al*. [73]. In the light of the above, the role of independent directors is not functioning as internal governance control mechanism in Malaysian PLCs possibly due to connection with the controlling or large shareholder, thus the vulnerability of corporate expropriation could not be reduced.

Board Diversity

Woman Director: This study finds negative and significant relationship between the female on board and dividend payout and lead to the rejection of hypothesis H2ac. It can be stated that the presence of female on board is not functioning as one of the internal governance control mechanism in the Malaysian firms. Similar to board independence, failure of female board members to play governance role could be due to their connection with the controlling shareholder in a highly concentrated ownership. Therefore their function could be largely influenced by the shareholders hence would possibly resulted to corporate expropriation.

Foreign Director: The result shows that there is a significant positive relationship between foreign board member and dividend payout. Hence, hypothesis H2b is accepted.This result suggests that foreign board members may influence to increase dividend distribution in the firms. The finding from this thesis is consistent with Oelheim and Randoy [37], Choi *et al*. [38], Ararat *et al*. [39] and Schwizer *et al*. [24], who stated that the presence of foreign board member could bring benefits to shareholders. Therefore, the finding could recommend that the presence of foreign board in firms is influential as an internal governance control mechanisms. Consequently, it could potentially reduce the agency problem and thus could minimize the vulnerability towards corporate expropriation.

Tenure of Independent Board: The results show that the presence of long board tenure is positively and significantly influence dividend payout in firms. Therefore, the hypothesis H2c that the presence of long board tenure has positive relationship with dividend payout is accepted. This finding reveals that long board tenure is functioning as a tool to promote a better board and improving the quality of governance and thus protecting the interest of the shareholders in Malaysian PLCs. This is consistent with the Kesner [42] that long serving director will make them more mature and Vefeas [41] that director tenure can be considered as determinant to measure the quality of director. Moreover, there are also having extensive experience, knowledgeable and high reputation as suggested by Liu and Sun [45], Liew *et al*. [44] and Sharma [60].

Board Remuneration: This study finds that the board remuneration is positively and significantly related to dividend payout and therefore hypothesis H3 can be accepted. It is consistent with the argument made by Ruparelia and Njuguna [50] that an effective role by the directors in maximizing shareholders wealth can be related to the positive and significant relationship between board remuneration an dividend. This result shows that firms with high board remuneration is expected to distribute high dividend to their shareholders hence alleviates expropriation. This result seems to provide support to the fact that remuneration is functioning as one of internal governance control mechanism in the case of Malaysian firms. Therefore, directors can be said to play their function in maximizing shareholders wealth.

CONCLUSION

The objective of this paper is to examine the relationship between board governance and corporate expropriation of public listed companies in Malaysia. Based on the agency theory, the investigation is conducted on the setting of whether the influence of the firms' board governance will have effect on the firms' expropriation. The findings indicate that all board governance mechanisms have significant relationships with corporate expropriation in Malaysia. The results signify that board governance mechanisms play a role in dealing with corporate expropriation in Malaysia. This study is conducted without classifying the firms according to ownership structure that can be categorized into controlling and large shareholders. Future study should be conducted to identify and separating the analysis of board governance of firms into controlling and large shareholders as the appointment of the directors are connected to the identity of the owner of the firms.

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