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Corporate Governance Structure and Firm Performance: A Case Study of Malaysian University Holdings Companies

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Abstract: This study analyses the corporate governance structure and performance of Malaysian public university holdings companies from 2010 to 2014. The sample comprises eight public university holding companies. Data was gathered by using three methods; survey, semi-structured interview, and documentation review. The board structure and board sub-committees' practices of these case organizations were evaluated against the best practice recommendation of (i) the Malaysian Code on Corporate Governance (MCCG) 2012 (ii) the Green Book 2006, and (iii) other relevant acts. The firm performance is measured using four indicators which are sales, profit before tax, net profit margin and return on equity. Overall, this study finds that the practice and structure of corporate governance of the holding companies are excellent. However, there are companies that did not comply with certain parts of the recommendations of Malaysian Code on Corporate Governance 2012 (MCCG) and the Green Book. The study also observed that the practice of governance between the university companies is not uniform. The analysis of firm performance, two companies, show the highest net profit margin and return on equity. One company reported negative earnings and return on equity. The other five companies reported the net profit margin below 10%. The findings provide an insight into the ministry of education as the shareholder to improve the monitoring of the public university holding companies.

Keywords: Corporate Governance, Firm Performance, University Holdings Company, Malaysia, Case Study

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1. INTRODUCTION

Corporate governance deals with the ways corporations are managed and governed (Doupnik & Perera, 2015, p.676) that involves a set of relationships between a company's management, its board, its shareholders and other stakeholders (OECD, 2015, p.9). The purpose of corporate governance is to build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies (OECD, 2015, p.7). Good corporate governance has been argued as vital to the growth and financial stability by underpinning market confidence and financial market integrity (OECD, 2004). Poor corporate governance may result in poor performance and could ultimately lead to corporate failure. Corporate scandals that had happened around the globe have exposed some of the weaknesses of a corporate governance system that is very crucial and urgent to be addressed. This issue has received considerable attention from various parties including governments, regulators, investors, the general public and the academia. While there are a significant number of studies that have been conducted on corporate governance (see, for example, Volonte, 2015; Baysinger & Butler, 2014: Bekiris, 2014; Mobbs, 2013: Masulis, Wang & Xie, 2012) the central attention has been given to the governance system and structure of public listed companies.

In Malaysia, public universities have been granted permission by the Minister of Higher Education to set up a holdings company and its subsidiaries to reduce the level of dependence on the Government fund. In general, by 2020 the public universities are expected to be able to pay 30% of the operating expenses of the university using their income generated (National Higher Education Strategic Plan 2007). The role and ability of university holdings companies to generate income for the university becomes even crucial as Malaysian Budget 2016 shown a significant cut over the Government's allocation to every public university. Moreover, following the budget announcement all public universities are urged by the Deputy Minister of Higher Education to be proactive to generate their income which one of the ways to do this is via the businesses carried out by the university holdings companies (Utusan Online, 2015). To successfully shoulder this crucial and arduous task in generating income for the universities the university holdings companies must be able to consistently produce an excellent financial performance.

Very few studies have empirically conducted to examine and assess the governance structure and performance of organizations other than the public listed companies. Hence, this study aims to investigate the governance structure and firm performance of university holdings companies owned by Malaysian public universities. Specifically, this paper attempts to address the following questions: (1) Does the governance practices of university holding companies are in line with the best practices recommended by the Malaysian Code on Corporate Governance (MCCG) 2012 and the Green Book 2006?; (2) How perform are the university holdings companies? The findings of this study are expected to provide input to the regulatory bodies for improvement of existing policies on performance and governance of university-owned companies and may provide new insight into the corporate governance literature.

2. LITERATURE REVIEW

2.1 Corporate Governance

Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (OECD, 2015, p.9). Corporate governance has been defined in many ways.

One of the definitions is "the rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders like employees and creditors" (OECD, 2004, p. 184). It also can be defined as a "system by which businesses are directed and controlled" (Cadbury, 1992). There are a considerable number of studies that have been conducted on corporate governance aspects, such as board structure, in various contexts or countries. One of the research streams on corporate governance focuses on the association between the practices of corporate governance (e.g. board structure and CEO turnover) with firm performance (Andersen & Gilbert, 2014; Masulis, Wang & Xie, 2012; Abdullah & Ku, 2013). Another stream of research focuses on determinants of corporate governance aspects/elements (e.g. CEO choice/turnover) (Guo & Masulis, 2015; Ishak, Ku Ismail, & Abdullah, 2012). Most of the prior studies, however, focus on the corporate governance aspect and system of public listed companies. Very few studies attempted to explore and examine the governance structure and system of other types of organizations. As mentioned earlier, this paper aims to investigate the governance structure and practices (i.e. the board structure and board-sub-committee) of university holdings companies owned by eight Malaysian public universities against the Malaysian Code on Corporate Governance (MCCG) 2012 and the Green Book 2006.

Various guidelines and codes of corporate governance have been issued by the governments and regulators to guide and assist companies to establish and practice good corporate governance. Malaysian Codes on Corporate Governance (MCCG) 2012 is the primary guidelines of corporate governance principles and codes for companies in Malaysia. Meanwhile, the Green Book, which was issued in 2006 by a select committee established by Malaysian Government, meant to provide guidelines to government-linked companies (GLC) in enhancing board effectiveness of the GLCs. The following are among the leading recommendations relating to board structure, one of the integral parts of corporate governance, which are stipulated in the MCCG 2012 and the Green Book:

a) The numbers of the board of directors are not more than ten directors.
b) At least one-third of the board members are independent/external directors.
c) The number of executive directors is not more than two directors
d) The role of chairperson of the board of directors and the chief executive officer/managing director of a company should be separated.

With regards to the board subcommittee, both MCCG 2012 and the Green Book recommended the board of directors to establish several sub-committees to be able to address specific issues more effectively. Among the sub-committees that are suggested by the MCCG 2012 and the Green Book are audit committee, remuneration committee, and nomination committee. Treasury Circular No. 9, 1993 provides guidelines on the establishment of audit committees for government companies to provide further monitoring and controls to the companies so that the interests of the government as a shareholder can be adequately protected.

2.2 Corporate Governance and Firm Performance

Figure 1 shows the conceptual framework of governance and financial performance of public universities companies. This framework was adapted from Cohen, Krishnamoorthy and Wright (2004) to clarify the importance of governance elements in improving the performance of public universities companies that examined in this study. As shown in the figure, the key stakeholders in the conceptual framework are Public University, Ministry of Higher Education (MOHE), Ministry of Finance Malaysia (MOF), Companies Commission of Malaysia and other stakeholders. The five elements of governance shown in the framework are the board of directors, audit committees, internal auditors, external auditors and management. As suggested by Cohen et al. (2004), these five elements of governance can affect the performance of the company. The framework also suggests that the relationship between governance elements and the interaction between these elements is essential to achieving the desired level of performance.

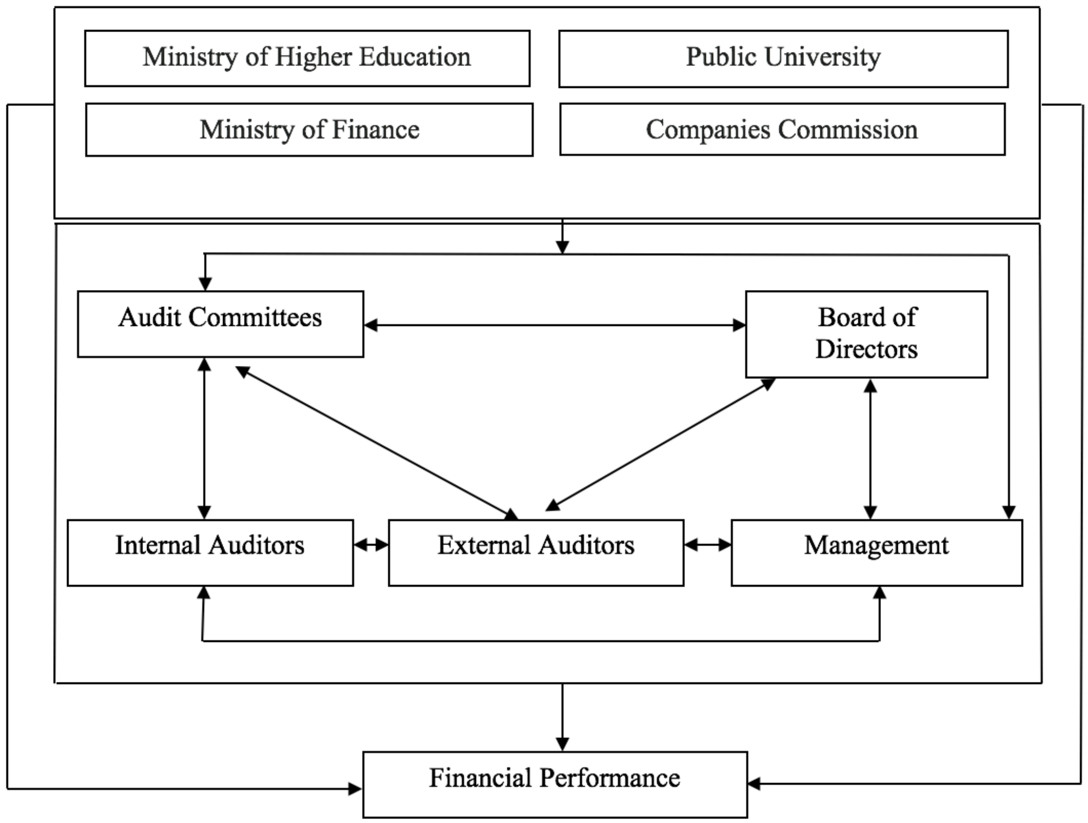

Figure 1. Conceptual framework of governance and financial performance

3. METHODS

3.1 Case Organizations

As shown in Table 1, the case organizations consist of eight university holdings companies owned by eight public universities in Malaysia. The name of the companies and the universities are anonymous to protect the identity of the organizations. These companies are established, as one of the ways, to enable Malaysian public university to generate their income and reduce their financial dependence on the government fund or grants.

Table 1. Case Organizations

No.	University Holding Company
1	Company A
2	Company B
3	Company C
4	Company D
5	Company E
6	Company F
7	Company G
8	Company H

3.2 Data Collection and Analysis

Data on corporate governance are collected for the year 2016 while data on financial performance are gathered for the financial years 2010 – 2014. Three methods were employed for data gathering; semi-structured interview, survey, and documentation review. 15 semi-structured interviews were conducted with 19 interviewees consist of a representative of top management and representative of the board of the case organizations. The interview questions were developed to instigate discussion on corporate governance practices and issues. All interviews, except with chairman of two case organizations, Company C and Company H’s board of directors, were tape-recorded and last between one to one and half hour. Interview note was also prepared for each interview particularly for non-recorded interview sessions to ensure all important data and information are captured and retained for analysis. All interviews were then transcribed and analyzed using thematic coding whereby five themes were used to analyze this data. Synthesis for each of the theme was then prepared by applying direct quotations from the interviews.

The survey was employed to collect data related to governance structure and practices of the case organizations. The questionnaire was developed based on the following sources (i) Green Book on Enhancing Board Effectiveness 2006 (ii) Malaysian Code on Corporate Governance (MCCG) 2012 (iii) Corporate Governance Guide, 2nd Edition, Bursa Malaysia, and (iv) Companies Act 1965. To ensure the clarity of the questions constructed the questionnaire, which has six sections, was reviewed by Head of Internal Audit of one public university before being distributed to the respondents. The questionnaire was distributed to the chief executive officer of the case organization. All questionnaires were answered and returned. Data from the questionnaire was analyzed descriptively to identify similarity and differences in the governance structure of the case organizations studied. Meanwhile, documents that were reviewed consist of a document issued by the case organizations such as an annual report. Other documents were also reviewed that consist of (i) university holdings company’s minutes of meetings, (ii) company policies and (iii) documents issued by the authorities such as the Act, Circulars, Guidelines and specific reports. There was also some information obtained from the Companies Commission of Malaysia and the Auditor General's website.

Data related to the financial performance of holding company was acquired through the company's audited financial statements. The document was obtained from the Ministry of Higher Education’s Governance Division, Companies Commission of Malaysia and from the holding company involved. Data were analyzed using simple statistics, such as the increase/ decrease in financial performance, percentage and also trends. Ratio analysis, such as net profit margin and return on equity were also conducted to measure the profitability and ability to generate a return on investors' capital.

4. FINDINGS AND DISCUSSION

Two vital components of corporate governance structure, the board structure and the board sub-committee, of the case organizations, are explored and examined against the two guidelines. The performance is assessed using indicators of sales, profit before tax, net profit margin and return on equity. The findings are presented and discussed in the following sub-sections.

4.1 Board Structure

Board structure as one of the vital component of corporate governance practices of university holding companies is presented in Table 2. The characteristics of corporate governance examined in this study are board size, board independence, ministry representative in the board of directors (BOD), vice chancellor in BOD, CEO duality, the existence of audit committee and percentage of subsidiaries where its chairman is a member of holding's BOD.

In term of board size, the university holding company with the largest board size is Company D. The number of directors in its BOD is 9 members. The smallest board size is 5 members of Company E and Company H. Overall the number of directors for these companies are not more than ten as per the recommendation of MCCG 2012 and the Green Book.

In term of board independence, Company C, Company D and Company H fulfil the requirement of MCCG 2012 and the Green Book where more than one-third of BOD members are from outside. Meanwhile, the percentage of independent directors in the remaining companies are less than what was recommended by the two guidelines.
However, efforts to adhere to the recommendation regarding the number of independent directors are being sought, for example by Company G and B as explained by the chief executive officer of the two companies:

> "*In fact, we are in the process of finding one more (Independent director)".*
>
> (CEO - Company G)

> *"We short of one independent. You see, there should be nine directors, there is only eight, and we are looking for one more*".
>
> (CEO - Company B)

All university holding companies have an audit committee on board except Company A.

Table 2. Board Structure of University Holding Companies

	Company A	Company B	Company C	Company D	Company E	Company F	Company G	Company H
CG1	8	8	8	9	5	6	8	5
CG2	12.5%	25%	50%	44.5%	20%	1.7%	25%	40%
CG3	2	4	2	2	4	3	4	2
CG4	No	No	No	No	Yes	No	No	No
CG5	5	2	2	3	0	2	2	1

Definitions:
CG1= Total number of members on the BOD
CG2= Percentage of independent directors in BOD (independent directors are not LPU/LGU members)
CG3= No. of executive directors
CG4= CEO Duality
CG5= Number of university executives on the BOD

The Green Book also recommends that the number of executive directors on BOD should not exceed two directors. Based on Table 2 four holding companies, Company A, Company C, Company D, and Company H meet this requirement. The role of chairman and chief executive officer/managing director is separated from all companies but is not practiced in Company E as the same person was holding both positions (CEO duality). Besides MCCG 2012 and the Green Book, the Investment Guidelines for public universities 2004 is another guideline that should be followed by the university holding companies. The investment guideline among other recommends of not more than two public university's officers to be appointed as members of the company's board of directors" (paragraph 3.2.5B). As shown in Table 2 all companies except Company E have university executives as the board members.

4.2 Board Sub-Committee

With regards to the board subcommittee, both MCCG 2012 and the Green Book recommended the board of directors to establish several sub-committees to be able to address specific issues more efficiently. Among the sub-committees that are suggested by the MCCG 2012 and the Green Book are audit committee, remuneration committee, and nomination committee. As shown in Table 3, all university holding companies, except Company A, have established the audit committee. Meanwhile, four companies that are Company B, Company D, Company E, and Company G have the remuneration committee. There are only three companies (Company B, E, and G) have established the nomination committee. In line with the recommendations of MCCG 2012 and the Green Book three companies, which are Company B, E, and G have established all the three board sub-committee as per the guidelines.

Table 3. Board Sub-Committee

	Audit Committee	Remuneration Committee	Nomination Committee	Risk Management Committee	Investment Committee	Other Committee
Company A	-	-	-	-	-	Yes
Company B	Yes	Yes	Yes	-	-	Yes
Company C	Yes	-	-	-	Yes	-
Company D	Yes	Yes	-	-	Yes	-
Company E	Yes	Yes	Yes	Yes	Yes	-
Company F	Yes	-	-	-	Yes	-
Company G	Yes	Yes	Yes	-	-	Yes
Company H	Yes	-	-	Yes	-	-

In addition to three committees as recommended by the MCCG 2012 and the Green Book several universities holding companies have also established a risk management committee (Company E and F) and an investment committee (Company C, D, E, and F). While it does not have the three sub-committee as recommended by MCCG 2012 and the Green Book, Company A have established an appointment committee of consultants, contractors and professional services, and procurement and purchase of assets committee. In addition to the three committees as per the recommendation of MCCG 2012 and the Green Book, Company B and H also established a tender committee and a remedial, grievance & disciplinary committee respectively. Management commitment and awareness to have a sound governance structure are as explained, for example, by a representative from one of the case organizations:

> *"After we start (the business) we have our policies and authority, which is clear because we have the audit committee, the remuneration committee, and the investment committee. There is a complete report on the Good Governance Green Book. "*
>
> (Managing director - Company D)

4.3 Firm Performance

Table 4 shows the financial performance of all university holding companies during 2010 -2014. The performance is measured using four indicators which are sales, profit before tax, net profit margin and return on equity. As presented in the table, Company G reports the highest average sales of RM102.36 million during 2010-2014 while Company E reports the lowest average sales of RM18.59 million. Consistent with the first performance indicator, Company G reports the highest average profit before tax of RM7.01 million and the university holding company with the lowest profit before tax is Company A that reports an average loss of RM6.11 million. The firm performance based on total sales and profit before tax might be biased as the indicators ignore the firm size effect. The better performance indicators are net profit margin and return on equity. As shown in Table 4, Company D reports the highest average net profit margin of 0.12 or 12% followed by Company B of 0.10 or 10%. Consistent with the previous result (profit before tax) Company A reports a negative profit margin of -0.21.

Table 4. Financial performance of university holding companies 2010-2014

	Sales (Mean) RM'million	Profit before tax (Mean) RM'million	Net profit margin (Mean)	Return on equity (Mean)
Company A	70.92	-6.11	-0.21	-0.67
Company B	30.67	3.78	0.10	0.60
Company C	56.27	2.50	0.02	0.31
Company D	41.06	7.01	0.12	4.04
Company E	18.59	0.54	0.03	0.19
Company F	34.18	0.98	0.02	0.07
Company G	102.36	7.01	0.04	0.83
Company H	29.92	2.15	0.04	0.14

Definition:
Sales = Total sales during the financial year
Profit before tax = Profit before income tax during the financial year
Net profit margin = Profit after tax divided by sales
Return on equity = Profit after tax divided by the number of issued shares

Other university holdings companies report the average profit margin ranging from 0.02 to 0.04 or 2% to 4% during the four years of study. The last firm performance indicator is a return on equity that measured the net income per unit of share invested. Consistent with the result of net profit margin, Company D generates the highest average return on equity of 4.04. This means that Company D generates about RM4 for every ringgit/unit of shares. Other university is holding companies that report good results are Company G and Company B with an average return on equity of 0.83 and 0.6, respectively. Again, Company A reports negative results. It generates negative return/loss to its shareholders. The average loss is 67 cent for every ringgit/unit of shares. Other universities holding companies report return on equity on a range of 0.07 to 0.31. In general, Company B and Company G are companies with the highest performance and Company A reports the worse result during 2010 -2014.

Table 5. Ranking of university holding companies based on financial performance

Ranking	University Holding Companies
1	Company D, Company G
2	Company B, Company C
3	Company E, Company F, Company H
4	Company A

Based on financial performance presented above, we rank all university holding companies into four groups as summarized in Table 5. Companies in Ranking 1 which are considered as the best-performing companies are Company D and Company G. Companies which ranked second are Company B and Company C. Three university holding companies are ranked third; Company E, Company F and Company H. The only university holding company that records negative performance is Company A that ranked last.

5. CONCLUSION

This study examines the corporate governance practices and financial performance of Malaysian public university holding companies from 2010 – 2014. The analysis of eight university holding companies shows that the practice and structure of corporate governance of the holding companies are consistent with the recommendations of MCCG 2012 and the Green Book. However, there are companies that did not comply with certain parts of the recommendations of MCCG 2012 and the Green Book, for examples, on the number of executive directors on BOD and the board sub-committees. The study also observed that the practice of governance between the university companies is not uniform. The analysis of financial performance of the organization cases shows that two companies are performing well and one company reports loss throughout the years under study. Given the nature of the case study approach employed in the study, the findings documented in this study are not appropriate to be generalized to other companies or contexts. However, the findings of this study may assist the relevant public universities and the Higher Education Ministry, by providing insight on the current governance practices of the companies, in improving the existing governance policies and practices of university-owned companies. The findings of the study also provide new insight into the corporate governance literature on university-owned companies. Future studies on university-owned companies may include all companies owned by a public university to provide more evidence on the issue of corporate governance. Linking the governance practices with the performance of the university-owned companies would also provide a fascinating insight into the related regulatory bodies.

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