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Corporate Governance, Audit Committee and Firm Performance: Construction Sector, CIDB Malaysia

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Abstract:

This study examines the association between corporate governance mechanism and firm performance measured by return on assets (ROA) among companies registered on one large government industry (Construction Industry Development Board – CIDB) in Malaysia. In this research, corporate governance mechanism consists of risk management committee, gender diversity, duality, ownership concentration and audit committee. The study conducted a survey questionnaire method and data are collected from 80 companies. Descriptive statistics is reported and model estimation is performed using logistic regression. The results shows that audit committee has significant impact on firm performance. Evidence suggests that audit committee is highly important in the area of corporate governance mechanism to enhance firm performance.

Key words: corporate governance mechanism, risk management committee, gender diversity, duality, firm performance, construction industry development board (CIDB).

1: INTRODUCTION

Corporate governance is a technique and structure used to control business exercises of the economic system of the organization towards expanding business triumph. Corporate responsibility with the extreme target of acknowledging shareholder value, whilst bringing under record the interest for different stakeholders. (MFC) defines Corporate Governance is a framework that eventually used to control and guided by the organizations. Top managerial staff is answerable for the governance of organizations. The shareholders' part for governance is to engage those executives and the auditors for the benefit of the firm and fulfill them to guarantee that a competent corporate structure is developed- Cadbury Report 1992. Corporate governance bargains with those components that guarantee that enterprises get a return based on their ventures (Shleifer et. al, 1999). Corporate governance arrangements not only the internal administration of the firms, it also connected with a firm's relationship with its suppliers, customers, and other stakeholders. The developing need for stocks and other assets from organizations expanded the vitality of corporate governance around the planet. Raising investment fund, liquidity with the view of profitability is highly competitive for the organizations.

Corporate governance turned a well-known finance exchange platform in the modern world. Generally, corporate governance determines firm establishment that defend and flourish the expectations of stakeholders which expanding worldwide considerations. However, those possibilities of corporate governance vary between countries, relying upon the economic, radical and furthermore social contexts. Organizations in rich economic countries divide shareholders jurisdictions that work in stable political, budgetary financial structures and developed legislative frameworks of corporate governance.

Corporate governance varies from entity to entity and geographical region of countries. Its ultimate goal is to standardize, gain high rate of return and to prevent financial structure in attaining their targets at the expense of the investors (Luo, 2007). It must be acknowledged that feeble corporate governance or noncompliance of its doctrine could prompt financial abuses, corporate frauds and generate heavy losses for the companies (Jill, 2008).

We explore the literature review based on corporate governance and firm performance. So far, no study exists related to return on asset measured as a binary variable in corporate governance characteristics. This study is the first effort explaining corporate governance issue in CIDB Malaysia registered companies with regards to return on assets as a binary variable.

2: LITERATURE REVIEW

Corporate governance channelizes the vitality of ownership concentration, board structure and also impact of stakeholders on the organizations. Over more diminutive companies, managers assume to play a critical part along with forming corporate esteem frameworks that effect organizations performance from months to years. Previously, bigger organizations that separate concentrated ownership, supervisors and their controls that assumes to play a capable role (Steen, 2004). The conceptual framework of corporate governance of earlier studies supports agency theory. This theory based on the fact that stakeholders targets can be accomplished if administrator’s speculation is under control (Jensen and Meckling, 1976). Company performance is found to be positively related to the directors' collective and individual attributes which are associated with access to information, effectiveness of board, observance of fiduciary responsibility and performance evaluation (Veysel et. al, 2006).

Bruce et al., (2002) concede that structural changes to corporate governance conventions, including stupendous execution and strategy formulation, more freedom about compelling audit reviews, effective transparency in the selection of top-executive appointments that would bring firm performance at top level. Compliance with and disclosure of good CG practices varies substantially among the different companies, and CG standards have generally improved over the period. The researcher also finds that block ownership is negatively perform against voluntary CG disclosure, while board committee size, audit firm value, cross-listing, the availability of a CG board committee, ownership of institutional and regulatory bodies are positively respond to voluntary CG disclosure listing (Collins et. al, 2012).

Corporate governance in established market economies has been fabricated regularly over several centuries as a value of the economic growth of industrialized entrepreneurship (Chowdary, 2002). CG assumes a main role in the execution of MFIs and the autonomy of the board and acceptable detachment of the role of a Chief Executive Officer and board chairperson that have a positive association with performance processes (Anthony et. al, 2008).

The origin of construction industry in Malaysia linked back to the British Organization. The highly qualified engineers from Britain and workers are supported by the foreign Government of Indian sub-continent to build a massive meter gauge railway track in the year 1882. The group of contractor consists of a small number of individuals from two to five people contributing facilities and working with the direction of an engineer or architect, engaged by the client (Sundaraj 2006; Tan 2004). The main contractors well managed and hire sub-contractors who tender for and acquire ventures to consequently leased portion of the projects in segments had been started from the beginning. It is still prevailing in present times (Sundaraj 2006; Tan 2004). The Malaysian administration preferred learning from other developed countries like Japan and Korea and continue the struggle to stand with the developed countries of Asia. Dayabumi building is one of the best examples of that strategy (Tan 2004).

Conversely, a Bumiputra engineering company complains that there are no actual technology transfer took place, they are also partner of Japanese contractors acclaimed that it is also just to maintain a good relationship with the government (Lavender 1996). The tourism industry also increased rapidly due to big development projects in non-residential areas like hotels, resorts, malls and golf courses which play a vital role in economic growth (BNM 1999). During the period of 1990-1997, the constructions of building projects become double especially in the Klang Valley. Therefore, the government took preventive measures in early 1995 to address the nation about asset bubble (BNM 1999). The procedure of foreign proprietorship for residential properties become relaxed with the new rulings introduced by the Government. The purchase of a house by a foreigner above RM250, 000 exempted from approval of the Foreign Investment Committee. The construction industry is affected in 2006 due to these initiatives (BNM 2007). During the period of recession, most of these entities are not able to sustain because all of the related corporations would be exaggerated, ultimately, the whole of the organizations at survival threat during the period (Tan 2004).

The Cadbury Code (1992) originates as a consequence of the corporate disasters in the 1980s in United Kingdom. It suggests modifications to the board structures and measures to make the entity more liable to the stockholders, advises growth in the number of independent directors on the board, separation of the chairman and CEO, and overview of board committees (Chowdary, 2002).

Using panel data regression, Ujunwa (2012) points out that size of the board, CEO/Chairman duality functions are negatively related to firm performance, whereas board independence have positive impact on firm performance and corporate governance. Similarly, corporate governance research has mainly influenced by agency theory.

Mansoor et al. (2013) concludes that the corporate governance mechanisms are able to overcome earnings management activities specifically from the perspective of family owned companies and the non-family owned companies. Corporate governance is widely practiced in general in Malaysia. The World Bank calls Malaysia a regional leader in corporate governance, but a lot of improvements required in the area of corporate governance. However, there are some gaps and omissions in the Companies Act and revising the Malaysian Code on Corporate Governance and Bursa Malaysia's Listing Requirements will help to reinforce board independence and support ongoing reform (Corporate Governance Report on the Observance of Standards and Codes for Malaysia, 2012). Noordin (1999), claimed that country's poor corporate governance standards are the main reason of losing investors' confidence in Malaysia. Therefore, this study is undertaken to fill this knowledge gap and to evaluate the impact of corporate governance on firm performance in construction industry in Malaysia.

2.1: Risk Management Committee

Risk management committee has the ability for the immediate identification, prioritization and oversaw economic risk, and in addition backing internal audit review functions of the audit review committees (Fraser and Henry, 2007). The stakeholders can hope their personal satisfaction of financial instruments regulations are higher along with organizations existing RMCs over to organizations having no such committees. This may be as a result RMC oversees different financial dangers that confronted towards the firm, subsequently those financial reporting value may be significantly improved (Yatim 2010). Research on risk management committee is very limited. Previously, majority of moments, role of risk assessment falls under audit committee review. However, Yatim (2010) proposes that the development of risk assessment board in Malaysia is not just connected with competent structure of board, extent of the entity and the unpredictability of a company's operations, but also their role linked with big 4 audit review firms which have been connected with high-quality regulations. Likewise Risk management committee has been accounted for to a competent board of directors (Yatim 2010).

2.2: Gender Diversity

Wang and Clift (2009) explain that women directorship has no significant impact on firm performance. The share of females farming the position of the board of administrators is going to be decreased from the year 2005 till 2007 at the speed of 10.2%, 7.6%, and 5.3% severally. Though, this share is marginally boosted in 2008 to 7.41% (according to kpwkm). The shortage of the contribution of Malaysian women directorship in important board decisions is disclosed at the World Economic Forum’s in World Gender Gap Index 2009, wherever Malaysia gets 5 places to a hundred and one from out of one hundred fifteen countries surveyed linked to a recent year (Hunt, 2010). It is consistent with an investigation carried out by Soares, et. al., (2010) that presented Malaysia is within the 9th rank of female on the board of director’s level between Asia Pacific organizations.

Moreover, analysis by Catalyst (2008) demonstrated that on the average, Forty five hundred corporations with a lot of ladies administrators had considerably accomplished big financial targets than those with the smallest amount by 53% over return on equity, 42% over return with sales, 66% over return on invested capital. (Julizaerma and Zulkernain 2012) demonstrates the policy of Malaysian government for minimum requirement of 30 percent women directorship in the board decisions of the financial departments. Additionally, women directorship has significant relation on company’s’ profitability in case of categorical data which is consistent with (Shrader et. al, 1997 and Maran and Indraah, 2009). While Julizaerma and

Zulkarnain. (2012) find a significant positive relation between firm performance and women directorship.

2.3: Duality

Masood et. al. (2013) shows that an independent board and CEO duality have correspondingly positive and negative association with firm performance. Joshua et. al. (2007), explains that board size, board composition, management skill level, CEO duality, inside ownership, family business, and foreign ownership have significant positive impacts on profitability. Chris et. al. (2009), highlight that there is a large amount of table discussion from board of directors in the process of financial structure decision-making, but found that there is no relationship between board of directors participation and corporate governance (board size, board independence and CEO duality). Ujunwa (2012) found that board size, CEO duality and gender diversity are negatively linked to firm performance, whereas board nationality, board ethnicity and the number of board members with a PhD qualification are found to impact positively on firm performance.

2.4: Ownership Concentration

Foreign investors tend to speculate in corporations with smart company governance as a result of effective company governance reduces agency cost and thus, declines financial hazards (Leuz et. al. 2008). Investors of financial institutions are typically have vital number of stocks within the corporations and want to safeguard their reserves. Giant group of investors have a robust incentive to observe administrators plus also the power to discipline the managers (Chang, 2003). Lei and Teen (2005) notice a positive correlation between financial institutions possession and company governance points for community corporations in the territory. Chang (2003) stated that considerable amount of financial institution investors are middle operators for final business owners. They need quite totally different incentives plus risk preferences as a result of they are subject to scrutiny through the ultimate homeowners thus, would perform higher.

McConaughny et. al. (2001) notice that corporations transferred from spouse and family are worthy and reasonable by nature of the business. Yammeesri and Lodh (2001) notice that company profitability are positively correlated with spouse & family possession. Kole and Mulherin (1997) study corporations with federal government possession of quite thirty fifth and notice that the performances of those corporations do not seem to be considerably totally different from alternative corporations within the same trade.

2.5: Audit Committee

Higher business performance depends on great legislation of good governance. However, over steady with the prior researchers that found, there is a blend of affiliation between useful review work of audit committee and firm performance (Hermalin and Weisbach, 1991; Dalton et a1., 1998). Through the observation of major stakeholders of business organizations that are more concerned with financial capabilities in the establishment of audit committee team members (Davidson et al, 2004). The Malaysian Code on Corporate Governance also states that members of the audit committee should have a sufficient understanding of financial reporting issues. MCCG suggested that minimum one member of audit review committees should be enrolled under the local accounting legislative council, mainly Malaysian Institute of Accountants, or should not be less than three years of experience after getting certification from a legislative body and must hold membership of prescribed accounting bodies (Shamser and Zulkarnain, 2001). A significant relationship exists between the extents of audit review committee with great experience of accounting, recurrence of the meeting in a year with profitability management practices (Norman, 2007).

However, the aggregate number roundtable meetings rely on the terms of reference and the unpredictability of the organization's operations. Not less than three or four face to face meetings should be corresponded with the audit review cycle and the timing about distributed twelve-month audit reports furthermore to other council meetings held in response to the available conditions throughout the financial year (Malaysian Code on Corporate Governance 2000).

2.6: Firm performance (Return on Assets)

The current study uses firm performance as dependent variable. (Norman, 2012) demonstrates that firm performance is negatively related to Corporate Governance reporting. Kevin et al. (1994) states that the level of return on assets raises when the concentrated ownership achieves a level of 68.2%, after that, return on assets declines. Morck et al. (1988), states that the entity role of performance inclines to increase when administration ownership tends to rise from 0% to 5%, and additionally, it declines when administration ownership expands from 5% to 25%.

The following is the firm performance measures investigated in this study, namely; return on assets (ROA), which is also considered as representative for profitability and market returns. Bilal et. al., (2013) reveals that there is a significant impact on board size, CEO/Chairman Duality on ROA, and there is an insignificant impact of Board Composition on ROA, whereas Return on asset that is also an accounting measure, is used to measure the productivity of assets engaged in firm performance (Haniffa et al., 2006). Less than 4% of Brazilian firms have “good” corporate governance practices, and that firms with better corporate governance have significantly higher (return on assets) performance (Andre et. al. 2005).

3: METHODOLOGY

The study uses quantitative approach utilizing primary data with convenient sampling procedure involving a sample size of 80 companies (Aminah et. al, 2012) companies registered in one large government industry (Construction Industry Development Board – CIDB) in Malaysia. Board of directors and managers were targeted in this study because they are directly involved in the overall running of the businesses, and their views often represent the views of the entire firm. A total of 80 questionnaires were collected and answered by either the company's directors or managers. Since the response variable (dependent variable) is dichotomous in nature, the study employed logistic regression (Takiah et. al, 2011). The logistic regression model uses the predictor variables (independent variables), which can either be categorical or continuous, in order to predict the probability of specific outcomes.

The return on asset variable is analyzed on a nominal scale. This variable is dichotomous in nature fulfilling the basic assumption of logistic regression. Return on asset considered 1 if increases than 5 percent (ROA >5%) and considered 0 if decreases than 5 percent (ROA <5%). (Richard, 2005) proposed that as a rule of thumb, investors are interested in those companies which have ROA more than 5%. (Ben, 2005) also stated that investors are reluctant to those companies whose ROA is less than 5%. (Dhanuskodi, 2014) also explained that as a fixed rule, expected level of ROA for companies is equal to or more than 5% which is considered good by the banks.

The target population for this research is the companies registered on Construction Industry Development Board (CIDB) Malaysia. The survey questionnaire consists of three sections. The first section contains information related to respondents. The objective of second section to measure firm performance which contains close ended question, "yes" or "no" if return on asset greater than 5% then yes and if less than 5%

then No. The objective of third section is to observe the perception of respondents towards governance which contains 5 point likert scale ranging from 1 equal to 'strongly disagreed' to 5 equal to 'strongly agreed' applied to evaluate firm performance in CIDB Malaysia. A total of 80 contractors of construction industry agreed and have participated in the current research. Upon receiving the consent from CIDB head office, the survey questionnaires are then courier to state offices. The total respondents according to CIDB states are shown in Table 1.

Table 1: Respondents of the Study

CIDB state offices	Planned sample	Real respondents	Rate of response
Selangor	75	50	67.0%
Wilayah Persekutuan	25	19	76.0%
Melaka	5	1	2.0%
Perak	5	2	4.0%
Sabah and Sarawak	5	3	6.0%
Pulao Pinang	5	3	6.0%
Johor Bahru	5	1	2.0%
Kedah	5	1	2.0%
Total	130	80	62.0%

The different types of grades are assigned to companies registered under CIDB. Grade 1 relates to small scale and then proceeds to large scale until grade 7 (CIDB, 2015). The breakdown of the respondents according to the level of grades (G1 to G7) and their measurements as designated by CIDB Malaysia are listed in Table 2.

Table 2: Respondents by Grades

Grade Registration	Construction Project value (RM)	Actual respondents	Response rate
G1	200,000 and less than	6	6.0%
G2	200,001 to 500,000	13	16.0%
G3	500,001 to 1,000,000	26	33.0%
G4	1,000,001 to 3,000,000	16	20.0%
G5	3,000,001 to 5,000,000	7	9.0%
G6	5,000,001 to 10,000,000	3	4.0%
G7	More than 10,000,000	9	12.0%
Total		80	100 %

To ascertain main factors of firm performance (Return on Assets), the return on asset considered 1 if ROA is equal to or greater than 5% and return on asset considered 0 if ROA is less than 5%.

To test the relationships suggested in the hypotheses stated in the conceptual framework, the SAS (9.4) statistical program is employed.

The final model that was fit to the data is given by

$$\text{logit FP} = \beta 0 + \beta 1RMC + \beta 2GD + \beta 3DU + \beta 4OC + \beta 5AC$$

where $\beta 0$ is the intercept of the model, $X1\ldots.,X5$ are the predictor variables risk management committee, gender diversity, duality, ownership concentration and audit committee respectively and P denoted the probability that the CIDB firm performance, is used.

The results indicate that audit committee has a significant coefficient in Table 8, whereas for other variables, they are found to be statistically insignificant.

3.1 Measures

All questions were answered from directors and managers by CIDB registered companies. The research is made for the purpose of evaluating the effects of corporate governance mechanism on firm peformance among companies in construction industry, Malaysia.

4: EMPIRICAL FINDINGS

This section presents corporate governance mechanism involving five elements: risk management committee, gender diversity, duality, ownership concentration and audit committee together with dependent variable firm performance measured by return on assets (ROA). All these predictor variables are analyzed against firm performance in each construction company. Observing the p-values, only audit committee provides evidence of a significant association with firm performance.

Gender information of the construction company is provided in Table 3.

Table 3: Respondents by Gender

Gender	**Responses**	**%**
Male	41	51
Female	39	49
Total	80	100

Table 3 implies that 51% respondents are male and the rest belongs to female. This is consistent with the policy of Malaysian government to accommodate minimum 30 % women directorship at the judgmental level of the financial industry (Julizaerma and Zulkernain 2012).

Table 4 provides information on the status of enterprise or Serdian Berhad construction company.

Table 4: Responses on Enterprise / Serdian Berhad

Status	**Responses**	**%**
Enterprise	53	66
Serdian Berhad	27	34
Total	80	100

About 34% are registered as Serdian Berhad and the rest belongs to Enterprise. As stated by Finance Minister II Datuk Seri Ahmad Husni Mohamad Hanadzlah, Small and medium enterprises consists of 99.2 % of the aggregate enlisted corporations in the country and subsidize 56.4 % on employment level, but their contribution at the GDP level is only 32 % and 19 % of the aggregate trade for the financial year 2005 (SMIDEC, 2008).

Table 5 provides information about the nature of ownership and management of construction companies.

Table 5: Responses on Ownership

Management by	Responses	%
Directors	77	96
Managers	3	4
Total	80	100

About 96% respondents indicated that CIDB construction industry sector is managed by directors and the rest of 4% by managers. The findings are in line with Bruce et al., (1998) where he stated that more than 80% of small and medium corporations are shifted from family shareholders.

Table 6 Reliability Analysis

Variables	No of items	Cronbach's Alpha
FP	1	0.894764
RMC	1	0.756610
GD	1	0.743855
DU	1	0.741322
OC	1	0.743355
AC	1	0.771640

Table 6 shows the results of reliability analysis by applying Cronbach's Alpha values according to the variables of constructs. The table shows the reliability of the 6 constructs are accepted as it exceeds than 0.6 (Aminah et. al, 2012).

The current research uses 5 items to measure the firm performance in CIDB registered companies Malaysia. These items are risk management committee, gender diversity, duality, ownership concentration and audit committee. We include all variables during the evaluation of data. The study performs factor analysis in a view to find the smallest number of factors that originates best choice of correlations and interpretable alliances of the variables. In order to find the number of factors, the scree plot test and the rule of Eigenvalues greater than 1 are employed (Aminah et. al, 2012). The analysis of the six variables revealed that two factors had Eigenvalues greater than 1. The results show that two factors together explain 76.0% of variation in the model. The factor loadings are between 0.471 to 0.770. All variables have positive correlation except performance. Normality of the given research data has been tested through skewness and kurtosis values (Hair et al. (2014).

Table: 7 Factor Correlation Matrix

	RMC	GD	DU	OC	AC
RMC	1.0000	0.6191	0.6318	0.7028	0.5876
GD		1.0000	0.7701	0.7178	0.5338
DU			1.0000	0.7359	0.4710
OC				1.0000	0.5272
AC					1.0000

On the basis of p-value in Table 8, that Cox and Snell Pseudo R square and Nagelkerke R square have a moderate value for the data. Nagelkerke R square is 0.1233 indicating that the independent variables in the model explain 12% of the change in the dependent variable. We can see that risk management committee, gender diversity, duality, ownership concentration are found to be statistically insignificant. While audit committee is found to be statistically significant.

Table 8: Logistic Regression Results

Parameter	**Coefficient**	**P- value**
Intercept	0.5646	0.7017
RMC	-0.9037	0.1391
GD	-0.4222	0.4753
DU	0.7991	0.2040
OC	-0.6006	0.3742
AC	1.0843	0.0430*
Cox and Snell Pseudo- *R* square		0.0915
Nagelkerke- *R* square		0.1233

*****significant at 5% level

5: DISCUSSION AND CONCLUSION

The findings reveal that risk management committee has no significant impact in case which is in line with Basiru (2015), explains that risk management committee (RMC) has insignificant relationship on firm performance (ROA). The findings also reveal that gender diversity has no significant impact which is in line with Wang and Clift (2009). The findings also reveals that duality has no significant impact which is in line with Lam and Lee (2008), found that CEO duality has no significant impact on firm performance. The findings also reveals that ownership concentration has no significant impact which is consistent with (Vafeas and Theodorou, 1998; Core and Larcker, 2002), also found no significant relationships between ownership structure and firm performance.

Additionally, audit committee has significant impact on firm performance which is consistent with Wild (1994). Harrison (1987) explains that audit committee supports external auditors in assessing effectiveness of internal system of an organization, thereby serving to improve the standards of monetary information.

Andersen et. al., (1989) postulates that successful business plan starts by exploring firm's underlying assets. The focal point of cost benefit analysis for every entity over its competitors is all of its resources must not be counterfeit by the contenders as these competitive advantages under the circumstances significantly take part in the successful company's profitability (Barney, 1991). Therefore, the firm's ability to attain low cost, greater adaptability and nature is a capacity of manufacturing policy and also corporate governance (Anderson et. al., 1989; Hayes et. al, 1984; Hill, 2000).

Though the study has theoretical contributions, it also contains quite a few limitations. First, the sample size in this study is limited (n=80). A very limited amount of respondents of CIDB registered companies take part which makes it harder to recognize the population represented by the given sample. The results cannot be generalized. Moreover, the sample structure is based on a data set consist of only construction industry and as such this may not be representative to all sectors like manufacturing, servicing in Malaysia. Second, the use of a single respondent for each entity may be subject to common method bias. Only directors or managers of the entities are chosen to gather the data for the research. Although the directors or managers may be the main person in the small enterprises, an individual's ability cannot represent the whole approach of the entity. Furthermore, the perceptual thoughts of the directors or managers may be partial because of their independent judgments. The third limitation is the use of only one accounting measure (return on assets) instead of more than one like return on equity (ROE) to increase the validity of results.

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