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IFRS Practice, Firm Performance and Corporate Governance: Evidence from Malaysia Textile SMEs

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Abstract:

The objective of this research is to determine if there is any significant relationship between corporate governance mechanism (accountant's experience, accountant's qualification, board size and presence of remuneration committee) and firm performance measured by practice of International Financial Reporting Standards (IFRS) among small and medium enterprises (SMEs) in a textile industry in Malaysia. Quantitative survey method is employed and data are collected from 30 companies. Descriptive statistics is reported and perform logistic regression as an estimation model. The finding reveals a significant positive relationship between the setting of remuneration committee and the practice of IFRS. This finding emphasizes the importance of establishing a risk management committee in sustaining the viability of an enterprise.

Key words: Corporate Governance Mechanism, Remuneration Committee, Board size, International Financial Reporting Standards (IFRS).

1: INTRODUCTION

Corporate governance is a procedure and structure used to control and manage company business activities towards increasing business success and corporate accountability with the ultimate objective of leading to long-term shareholder value appreciation, whilst taking into account the interest of other stakeholders. According to definition as per the Finance Committee on Corporate Governance in Malaysia, Corporate Governance (CG) is the system by which companies are directed and controlled. Board of directors are responsible to take special care of governance aspect in their companies. The shareholders' role is to appoint the directors and auditors and to satisfy themselves so that an appropriate structure is in place (Cadbury Report, 1992). Corporate governance deals with certain mechanisms so that corporate investors get a return of their investments (Shleifer and Robert, 1999). Corporate governance deals not only with the firm internal management, but it also looks into a firm's relationship with its suppliers, customers, and other stakeholders. The growing demand for capital and other resources from businesses has increased the significance of corporate governance worldwide. The task to raise financial capital while retaining profitability and liquidity is not an easy feat for some companies.

Corporate governance becomes more significant in developed and developing countries over times. The most popular view is that corporate governance determines firm enactment and protects stakeholders' interest, this in fact leads to widespread global attention. However, corporate governance practice is structured differently between countries, depending on the country economic, radical and social aspects. For example, most companies in developed countries treat shareholders as a separate entity and they operate the business with privilege such as political stability and financial security, established governance frameworks and effective corporate governance practices.

Corporate governance differs from entity to entity and country to country. The ultimate objective of corporate governance is to standardise, attain high profitability and prevent those in managerial position from pursuing their own objectives at the cost of the shareholders (Luo, 2007). In fact, weak corporate governance or lack of adherence to its principles can lead to corporate improper conducts, frauds and poor performance among the companies (Niamh and Jill, 2008).

2: LITERATURE REVIEW

Corporate governance mechanism highlights the importance of ownership structure, board composition and stakeholder influence. In smaller companies, owners play a role in determining corporate value systems that steer the companies for years. In larger companies with separate ownership and control, managers and boards hold an influential role (Steen, 2004). Company performance is found to be positively related to the directors' collective and individual attributes, which are associated with access to information, board effectiveness, observance of fiduciary responsibility and performance evaluation (Veysel and Ekrem, 2006).

Bruce and Alexander (2002) concede that structural reforms in corporate and agency governance conventions are crucial. This includes better focus on performance and strategy, greater independence for a more effective and extensive audit processes, greater transparency in the nomination and remuneration package for top-executive appointments. Compliance with and disclosure of good CG practices varies between the sampled companies, and in general CG standards of these companies have improved over the five-year research period. It was also found that block ownership is negatively associated with voluntary CG disclosure, whereas board size, audit firm size, cross-listing, CG committee presence, government ownership and institutional ownership are positively related to voluntary CG disclosure (Collins et. al., 2012).

Corporate governance in established market economies is regularly designed over several centuries, it is regarded to be valuable in spurring economic growth of industrialised entrepreneurship (Chowdary, 2002). Its role is critical in the performance of MFIs and in fact, board independence and clear separation between CEO and board chairperson positions have a positive correlation with both performance measures (Anthony and Kofi, 2008).

In manufacturing sector, the Small and Medium Enterprise Corporation Malaysia (SME Corp. Malaysia) defines small and medium enterprises (SMEs) based on annual turnover of not exceeding RM50 million or number of full-time employees not exceeding 200. In addition, the performance of small businesses is evaluated from their capability to drive employment rate and raise capital via business start-up, existence and sustainability (Sandberg et. al., 2002). According to the statistics presented by the SME annual report 2010/2011, SMEs represented 99.2% of the industry in Malaysia in 2010. Thus, SME performance is critical in transforming Malaysia into a high-income nation and knowledge-based economy by 2020. Despite SMEs' significant contribution to Malaysia's export growth, the SME economic value varies from state to state. For instance, the SME development in Perlis is slower as compared to Selangor and Kuala Lumpur. A study conducted by Zindiye (2008) on the SMEs in Harare, Zimbabwe reveals that industry structure, business norms and culture do influence SME performance. Although the findings cannot be extrapolated to the Malaysian SMEs, it is useful to scrutinize how corporate governance influences SME performance. Therefore, comparable studies should be carried out provide better understanding of the findings.

Indeed, many studies had been conducted to look into the identification of factors affecting SME performance, especially those pertaining to the manufacturing industry and some areas in the service industry (Karen et. al., 2007).

However, there is no extensive studies that are related to the performance of SME financial statements.

The Cadbury Code (1992) is instituted due to corporate disasters which during the 1980s in United Kingdom. This code suggests board structures modifications and measures to ensure an organizational entity is more liable to the stockholders, advises the increase in the number of board independent directors, separation of chairman and CEO roles, and board committee overview (Chowdary, 2002).

Utilising panel data regression, Ujunwa (2012) points out that board size and CEO duality are negatively related to firm performance, whereas board independence has positive impact on firm performance and corporate governance. Similarly, research on board characteristics is mainly influenced by three different theories; agency theory, stewardship theory and resource dependence theory.

Mansoor et al. (2013) conclude that corporate governance mechanisms are able to overcome earnings management activities from the perspective of family-owned companies and non-family owned companies in particular. Corporate governance is practiced throughout Malaysia. The World Bank regards Malaysia as corporate governance leader in this region, however there are rooms for improvement. In fact, there are gaps and oversights in the Companies Act 1965 and the revision of the Malaysian Code on Corporate Governance and Bursa Malaysia's Listing Requirements will facilitate in reinforcing board independence and supporting ongoing reform (Corporate Governance Report on the Observance of Standards and Codes for Malaysia, 2012). Therefore, this study was undertaken to fill the gap and evaluate the impact of corporate governance on firm performance of textile industry in Malaysia.

3: METHODOLOGY

The study uses quantitative approach utilizing primary data with non-probability convenience sampling of 30 companies (Manakotla and Jauhari, 2007). Owners and managers are the respondents in this study because they are involved in running the businesses, and their views often represent the entire firm. A total of 30 questionnaires were distributed and answered by directors or managers of those companies. Since the response variable (dependent variable) is dichotomous, the study employed logistic regression (Hussain and Hadi, 2017). The logistic regression model uses either categorical or continuous predictor variables (independent variables) to predict the probability of specific outcome.

The target population for this research is Textile SMEs of Malaysia. The survey questionnaire consists of two sections. The first section contains information related to respondents and objective to measure firm performance. The second section which contains mostly close ended question, “yes” or “no” if practicing IFRS then yes and if not practicing IFRS then No. The measurement of variables is briefly explained in Table 1.

To measure firm performance of companies, the study adopts IFRS practice (MIA), a binary variable was computed at the initial stage to represent the SMEs with or without IFRS practice, as shown below,

$$\text{Firm Performance (IFRS Practice)} = \begin{cases} 1 & \text{companies that practice IFRS} \\ 0 & \text{otherwise} \end{cases}$$

The final model that fits the data is illustrated by

$$logit\ IFRS = \beta 0 + \beta 1YE + \beta 2QF + \beta 3BS + \beta 4RC$$

where $\beta 0$ is the intercept, the four predictor variables; accountant’s experience (YE), accountant’s qualification (QF), board size (BS) and remuneration committee (RC) respectively while *P* denotes the probability of an SME is practicing IFRS.

3.1 Measures

All questions were answered by directors and managers from 30 SMEs. The research is intended to evaluate the effects of corporate governance mechanism on IFRS practice among textile companies in Malaysia.

4: EMPIRICAL FINDINGS

This section presents corporate governance mechanism that involves four elements; the accountant's year of experience (YE), accountant's qualification (QF), board size (BS) and the presence of remuneration committee (RC). The influence of these four predictor variables on the IFRS practice in each textile company was analysed.

Table 1: Descriptive Statistics for variables

Variables	Measurement	Respondents	%
Practice of IFRS	*Yes*	24	80
	No	6	20
Experience of accountant	*1 year*	4	13
	3 years	20	67
	5 years	6	20
Qualification of accountant	*Graduate*	4	13
	Master	4	13
	ACCA / CA / CPA	22	74
Board size	*2 directors*	14	47
	5 directors	13	43
	7 directors	2	7
	Others	1	3
Remuneration committee	*Yes*	19	63
	No	11	37

Table 1 presents the descriptive statistics of the corporate governance components used in the study. This table also shows the percentage of respondents for different levels of each variable. With respect to firm performance around 80% respondents agreed that their companies accruing practice of IFRS. In the case of experience of accountant, 67% of respondents agreed with minimum 3 years of experience. In terms of qualification of accountant, 74% of respondents are agreed with ACCA / CA /CPA and around 13% agreed with graduation and master. The later is board size, 47% respondents agreed with 2 directors which is ideal upon their perception. The next one is remuneration committee, 63% respondents agreed with the presence of this committee.

Table 2: Pearson Correlation with two tailed p-values

	IFRS	YE	QF	BS	RC
IFRS	1.000				
YE	-0.058	1.000			
QF	-0.304	0.146	1.000		
BS	0.223**	-0.181	0.188	1.000	
RC	0.484**	0.032	-0.058	0.433	1.000

The outcome from Table 2 shows that multivariate estimation is possibly have low multicollinearity impediments due to the which correlation coefficients are short (Takiah et. al, 2011). The uppermost unconditional correlation coefficient (0.484) lies among remuneration committee based (RC) and international financial reporting standards (IFRS).

The results from maximum likelihood estimates in Table 3 indicate that null hypothesis is rejected and suggests that the specified model is valid and adequate.

Table 3: Maximum Likelihood Estimates

Parameter	Estimate	P - value
Intercept	-3.0193	0.3196
YE	-0.1105	0.9121

Parameter	Estimate	P - value
QF	-1.2790	0.1183
BS	-0.4154	0.5914
RC	2.7354	0.0576**
Cox and Snell Pseudo R^2		0.2840
Nagelkerke R^2		0.4491

******significant at 5% level

Based on *p* values in Table 3, it is shown that RC has significant coefficient at 5% level which is consistent with Muhammad et. al. (2009), while other variables are statistically insignificant which is inline with (Hussain and Hadi, 2015) who also found that corporate governance has no significant impact on firm's performance.. According to Table 3, that Cox and Snell Pseudo R square and Nagelkerke R square have a significant value for the data. Nagelkerke R square is 0.4491 representing that the independent variables in the estimation model explain 45% of the change in the dependent variable. With a *p* value of 0.11, QF is approaching conventional significance level at 10% but it does not meet the cut-off point. So, a corporate governance mechanism to be credible, it should involve risk management operations and the initiation of RC is part of the processes. As such, the presence of RC in a company transcends not only improvement in terms of company's accountability but also its transparency level.

5: DISCUSSION AND CONCLUSION

This research provides additional knowledge by providing empirical evidence of CG mechanism contribution on IFRS practice among SMEs in the textile industry in Malaysia. Cormier (2010) suggests that formal monitoring attributes (board and audit committee size) reduce information asymmetry issues. Hence, SME owners or managers are advised to adopt IFRS in order to realise the potential value of corporate governance.

Using panel data regression model, Ujunwa (2012) reveals that board size and CEO duality is negatively associated to firm performance, whereas board independence has positive impact on firm performance. Most of the research done on corporate governance are influenced by agency theory, stewardship theory and resource-based theory. The theories seek to identify factors that influence firm capability in gaining and sustaining competitive advantage. The theories assert that a firm's performance is mainly driven by a set of firm resources as well as transparent governance and efficient operational.

Schroeder (1989) postulates that a particular strategy can be devised by exploring the firm's internal resources. To have a competitive advantage over its competitors, a firm should be aware that resources must be exclusive and novel, in which they are not easy to be replicated by the competitors. These competitive advantages contribute significantly towards firm's performance (Barney, 1991). Therefore, the firm's ability to achieve low cost, high flexibility and high quality is a valuable manufacturing strategy and corporate governance (Hayes and Wheelwright, 1984; Hill, 2000).

Though the study has contributed in terms of theoretical knowledge, there are few limitations. First, the sample size is limited (n=30). The lower response rate makes it hard to get a close representation of the population from the given sample. Moreover, the sample is only based on a data set that consists of textile-related SMEs so this does not represent all SME sectors in Malaysia. Second, the use of single respondent for each entity may attribute to common method bias. Only directors or managers from the companies are chosen to provide data for the research. Although directors or managers are the persons who have the control in determining direction for any firms, an individual's opinion cannot represent the whole entity. Furthermore, the thoughts that come from directors or managers may be restricted due to their partial judgments of a company situation. The third limitation is the cross-sectional nature of the study. Cross-sectional study does not explain the reason behind resulting correlations and this limits the fundamental part of the variables. Besides, the data can only provide a snapshot at one point in time. So, the outcome based on sequential snapshots are limited to the period in which the data are composed. Therefore, future research should consider the use of longitudinal survey (cross-sectional and time series data) as this would permit organisations to be evaluated over time and provide further understanding behind the findings.

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