

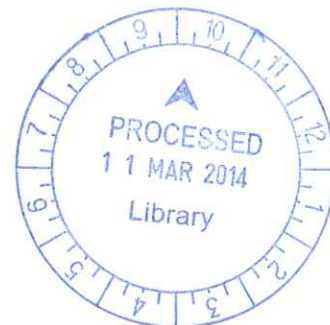
INTI INTERNATIONAL UNIVERSITY

MASTER OF BUSINESS ADMINISTRATION

BOARD STRUCTURE AND FINANCIAL PERFORMANCE OF
MALAYSIAN LOCAL COMMERCIAL BANK

FOR REFERENCE ONLY

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ABSTRACT

This paper examines the relationship between Board structures and financial performance of Malaysian local commercial bank. The characteristic of board structure, including board size, board composition, ethnic diversity and gender are addressed in the Malaysian. The study used a sample of eight local commercial bank of Malaysia between 2008 to 2012. The finding showed that board size, board composition and gender has U shape linked with financial performance. Whereas, ethnic diversity has positive relationship with financial performance. The two theories of corporate governance, namely agency and resource dependence theory is used on the study. The Ordinary Least Squares (OLS) regression was used to estimate the relationship between financial performance (ROE) and the independent variable.

Keywords: Board structure, Corporate Governance, Board of Directors, Financial Performance, Regression analysis.

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Declaration by Candidates

I hereby declare that this research project is of my own effort expect for the information that has been used from various authors that have been cited accordingly and ethically.

Maidul Hossain

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List of Abbreviation

ANOVA	Analysis of variance
BNM	Bank Negara Malaysia
GDP	Gross Domestic Product
M&A	Merger & Acquisition
MCCG	Malaysian Code on Corporate Governance
OLS	Ordinary Least Square
PLCs	Public listed Companies
ROA	Return on Assets
ROE	Return on Equity
UNDP	United Nations Development Program

Chapter 1

Introduction

1.0 Introduction

In this chapter 1 it's provide general overview of the research. It aims to give readers a general outline of the research background, problem statement, research objectives, significance study and scope of study are described in this chapter.

1.1 Research Background

According to the Ho and Wong, (2001) Most of the Asian countries sought the ways to make their corporate governance, disclosure and transparency levels strong after the Asian financial crisis took place in 1997. Noordin, (1999b), Malaysia's investor confidence got destroyed because of the poor corporate governance standards; as well as due to the deficiency of transparency in the financial system. So to support the director's interest with the shareholders is very significant for an effective system of corporate governance. In board structure, the board of directors carry a certain significant role and duty like endorsement regarding the organization's strategy, advancing directional policy, appointing, supervising along with remunerating senior executives. Moreover they need to confirm responsibility of the organization to its stakeholder's shareholders, and to other authorities. In corporate governance, the comparative effectiveness always play a very crucial role behind increasing the positive performance of a business. The consequences that comes out from the organization are due to the board characteristics which are identified by the most of the literature on corporate

governance. The outcomes of these kinds of issues as board composition (like 1991, Baysinger et al; 1985, Chaganti et al; 1987, Kosnik; 1989, Schellenger et al) and also as board size (like 1999, Dalton et al; 1973, Pfeffer; 1978, Pfeffer and Salancik; 1989, Singh and Harianto) were inspected the early researches on organization performance and strategic decisions. The arrangement of board consisting board composition and executive directors (also known as 2-tier board) has made the recognition by contributing and helping in the organization. All the directors were with mixed skills from different background. Direct responsibilities were in the part of the executive directors such as controlling the company's business and resources whereas independent decision to tolerate on the various matters such as resource, performance and strategy resources along with the main appointments and morals of conduct were the duties of independent directors. However, the tasks are not so easy and not always harmless for independent directors. Therefore, this is for sure not a matter to take lightly. Financial liability, important exposures possible prohibition including the significant harm to future careers all belong here. Lawfully director from independent category and director from executive category carry the same duties. However to get the effectiveness in their work, one need to influence decisions rather than managing operations. In the organization's group, board composition is counted as a non-executive director. This director possesses reliability, independence and expertise to keep the interests of all the different shareholders steady. Everything was planned in this way so that the decisions of board achieves objectivity as well as safeguard organization's general interests, along with minority shareholders. The organization's level of compliance of corporate governance is to be developed by the Independent directors.

In Malaysia, the most important foundation stone of the business governance reforms agenda is the Malaysian Code on Corporate Governance (2007). The procedures on the moralities, most excellent follows in corporate governance and the course for the execution including the plans the future projects of corporate governance is supplied by it in Malaysia. For helping to manage the board's

performance in business operations, corporate governance is considered as the main key and role in company performance. In a company, minimum two persons should be involved or at least 1/3 in the independent directors for making sure the accountability towards shareholders. This was commenced in Bursa Malaysia's Listing Requirements. This same is being encouraged by the Code for the board's successful functioning. For managing the steadiness of the board and for working helpfully, the director's from the independent category perhaps contribute to the board with the help of their executive colleagues and at the same time supplying independent judgment at times of need. Matters where the characters of chairman and CEP are shared might have the largest threat. This is really very important and essential to have enough independent directors.

The tasks and duties regarding making divisions between chairman and CEO must have to be accepted in obvious ways. This must guarantee stability in power and authority to such an extent that unregulated power in the matter of decision-making must not be any of the directors. If any consequence appears regarding the board structure and financial performance of Malaysian local banks, then research should be done in order to study them and this is the aim behind it. In the context of Malaysia, there is a shortage of the literature on these two governance limitations, board structure and financial performance. This is the intention behind the research is to inspect the connection between board structure and financial performance as calculated by return on equity (ROE) by means of models of local Malaysian banks.

1.2 Overview of Banking Sector in Malaysia

In 1957 Malaysia has got their independence. But their financial system was being initiated before the independence when financial institution were only being operated in the country by the foreign banks. Contrary to this, Matthews and Ismail

(2006) the Central Bank of Malaysia (Matthews and Ismail 2006) brought the end in the period of waiting for domestic banks, which waited for this start until 1959. The financial institution of Malaysian has formed by 25 commercial banks where 9 were possessed by domestic banks and 16 were possessed foreign banks. Islamic banks were 16 in number, 5 Islamic banks were from abroad, 15 were the investment banks and there were 2 other financial institutions, claimed by BNM. Moreover, in 2004, the commercial banks were formed by 10 domestic and 13 foreign banks according to a research of Sufian (2009). By 2008, together with 9 local and 13 foreign banks the Malaysian commercial banks were formed, according to the research of Said and Tumin (2011). Some domestic banks looked for progression in their work by joining which had resulted them in being refused. For example, Ong, Teo, and Teh November (2011) explain on May 2011, these two banks named EON Bank and Hong Leong Bank went for the bank merger, and this was the last one. Ever since 1959, a lot of crisis have been occurred in Malaysian Financial institutions. For example, 1985-1986 and 1987-1989. And this is only regarding the inside of the Malaysian banking system. Contrary to this, the outside crisis was brought in 1997-1998 which was the Asian crisis, and in 2001 the dot.com bubble and the Global Financial crisis in 2008. In general, if we look into the entire crisis, the mostly harmed institutions were Malaysian commercial banks. According to Khoon and Hui (2010) this is due to the crisis that occurred in Asia starting from Thailand and ended up being the most horrible crisis in the Malaysian banking history. In addition also due to 2008 Global Financial crises also took place and so this research would be elaborated more.

1.2.1 Current Banking System

A combination of Investment banks and commercial banking industry is desirable in the banking sector as it analyze even deeper despite the importance of having

Investment banks. International Monetary Fund (IMF) and the World Bank a label of well capitalized has been given to Malaysian banking institutions, according to a recent report. It was also mentioned in the report that over the last five years an appreciably improvement has been noticed in the asset quality bringing a benefit in banks. There are more chances of dangers in some smaller banks but still according to Stress tests, there is flexibility in banking system compared to economic and market shocks. Nevertheless, there was an added point that a potential liability is liquidity, given banks' dependence on demand deposits.

Last year household debts have gone beyond 80% for a short time which is obviously a matter of worry. In the region, it is the highest at present and at the same time among the highest in Asia. This situation took place for offering an easy opportunity to get loans in Malaysia, particularly loans regarding housing, car and credit card. As a result an increased supervisory focus is brought in and a range of macro-prudential measures was initiated. On the other hand, the rate is low in the present banking industry NPL whereas the rate of auto loans and non-residential property's non-performing loans (NPL) is rising. In February 2013, the rate of 2.02% NPL was at a meager. In January 2013, outstanding loan loss coverage dipped from 99.0% to 98.5% in February.

The optimistic part is over the years the banking sector significantly developed due to the increase in loans. Bank Negara published some figures which says, in January and February 2013, household loans increased to 12% and 12.2% correspondingly. At the same time, in these two months, the complete amount of bank loan is also raised by 11.3% and 11.4% respectively. Because of credit card spending throughout the festive period, shares investment and auto loans, this increment has taken place in home loans. The ratio of lending-to-deposits of the banking sector reached at 82% in total in the end of February 2013. A strong and good growth rate of 12.4% year-on-year was constantly recorded by Current and time deposit accounts. The yearly growth rate of the banking sector for 2013 is going to be approximately 10.5% according to the calculation made by Maybank

Investment Bank, due to this optimistic growth rate concerning loans. A constant record of strong momentum is observed in the report that the residential and non-residential property loans with respect to specific loans rising at 13% and 20% respectively. Now a momentum is still being gathered for the car loans while rising this year at 8% just in February.

1.2.2 Domestic Commercial Bank

According to the study of Faezah (2007), just after a couple of years of the Malaysian independence the Central Bank of Malaysia, Bank Negara Malaysia (BNM) managed the commercial banks since 1959. Twenty five commercial banks (formed by sixteen foreign banks and nine domestics' banks)

In the field of banking system, the domestic commercial banks are always working as an important part from the beginning as they are the ones who are the biggest and most important funds providers in the banking system. Huge possibilities are available for them regarding banking activities and business that were approved by the Minister and settled under the terms conditions bank Negara Malaysia recommended the license. In General, it not permissible for Commercial banks to engage in leasing and hire- purchase, as well as corporate advisory and factoring activities. This is due to shun harmful corresponding of accomplishments related to banking with other financial organizations especially the finance companies and the merchant banks. In Malaysia, the functions and business of commercial banks are:

- i. To make available credit and loans services, for every borrowers and also for corporations;
- ii. To make available services for effecting payments on behalf of its customers;
- iii. To make available services for saving by current, fixed/time deposit and saving accounts and also other financial instruments;

- iv. By buying treasury bills and government securities, backing the government; and
- v. To make available a large range of other banking amenities like financing for international and as well as domestic trade, facilitating foreign exchange transactions and the remittances.

Due to huge contribution of Commercial banks, the country has gone through a huge progress economically. And this is because they have provided all around the country, a huge network of branches.

Table 1 List of Licensed Commercial Bank in Malaysia

No	Banks	Ownership	Date of Establish	Total Asset (USD Billion)
1	Bank Negara Malaysia	Central Bank	1959	1209.92
2	Affin Bank	Domestic	2000	15.4
3	Allance Bank	Domestic	2004	10.4
4	AmBank	Domestic	1975	42.4
5	CIMB Bank Berhad	Domestic	1965	88.3
6	Hong Leong Bank	Domestic	2011	43.2
7	Malayan Banking Berhad (Maybank)	Domestic	1960	110.3
8	Public Bank	Domestic	1972	74.2
9	RHB Bank	Domestic	1966	31.6

Sources: the web side of each bank and annual reports