A Conceptual Paper on Impact of Corporate Governance on Operating Performance during Goods Service Tax Implementation in Malaysia

Sitraselvi Chandren[#1], Ayoib Che Ahmad[#2], Zaimah Abdullah[#3]

[#]*Tunku Puteri Intan Safinaz School of Accountancy, Universiti Utara Malaysia, 06010 Sintok, Kedah*
[1]Sitraselvi Chandren@uum.edu.my

***Abstract*— The purpose of this conceptual paper is to address the link between corporate governance and operating performance during and after GST implementation. With the support of agency theory, this paper develops five propositions for the relationship between corporate governance and operating performance (sales growth and current ratio) during and after GST implementation. The nature of their relationship shall contribute to all stakeholders on the impact of corporate governance to operating performance. This displays on the governance effectiveness in discharging their roles to strengthen operating performance particularly during a new financial or tax policy implementation that requires necessary changes in business processes. It uncovers the transparency of Malaysian corporate governance commitment and acceptance to GST for firm and country sustainable development. In sum, for business friendly GST requires effective governance to support the firm operating system.**

***Keywords*—** *corporate governance, current ratio, chief executive officer, directors, operating performance, sales growth, Malaysia*

1. Introduction

Goods Service Tax (GST) was first introduced in France in year 1954 for their country revenue. Presently, more countries in the world adopted GST and it has been the centrepiece of tax reform in many developing countries. Reported by [1] GST became an important part of the tax systems in many countries globally. GST is imposed on goods and services at every production and distribution stage in the supply chain including importation of goods and services.

The first ASEAN country that implemented GST is Indonesia in 1984 with 10 percent GST rate. Followed by other ASEAN countries, namely Thailand, Singapore, Philippines, Cambodia, Vietnam and Laos implemented GST as part of their countries' taxation system. The GST is imposed on most transactions in the production process with refund entitlement to all relevant parties in the chain of production other than the final consumer. GST was implemented in Malaysia on 1 April 2015 at a 6 percent tax on the taxable supplies. Malaysia regards GST as a value added tax. In Malaysia, corporate tax is a common word that gives direct impact to firms' financial position and cash flows but GST is a new practice for firms and the impact to firm performance is still plausible to all stakeholders and our government. Any unfavourable impact to firm operating performance during GST implementation may contribute negatively to shareholders value. Thus, strong contribution is needed from the corporate governance as to protect the firm and shareholders value. According to [2] report that during GST implementation firms should have capability to set the right pricing to earn sufficient profit and enough level of cash flows for business operation.

Thus, the implementation of GST in business processes requires a proper system to avoid unfavourable outcome in firm operating performance that ultimately reduces shareholder value. The revenue measured by sales growth indicates on the operating revenue management of the firm. The liquidity position measured by current ratio reflects on the short term operating fund management of the firm. Thus, this paper has conducted the mean difference analysis of 265 Malaysian listed firms based on their market capitalization using the paired t-test. This paper analysed sales growth (SG) represents the firm pricing and current ratio (CR) represents the liquidity performance before (2014), during (2015) and after (2016) GST implementation.

The Figure 1 presents the operating performance analysis for the before, during and after GST implementation. The operating performance analysis results show that the sales growth decreased during GST, however managed to

International Journal of Supply Chain Management
IJSCM, ISSN: 2050-7399 (Online), 2051-3771 (Print)

recover after the GST implementation period. This reflects that firms have restored the price setting policy and sales position immediate after the GST implementation period. For current ratio position displayed a good track of record where the liquidity position enhanced during and after GST implementation. In sum, the firms are able to manage the sales and short-term operating commitments. This reflects on the strength of the firm operation with the presence of strong corporate governance in managing the financial and operation matter of the firm. This is a learning curve process during implementation of new tax or financial policy in firm business operation that can be compensated through an effective corporate governance practices. Good corporate governance positively correlated with greater firm performance [3]. The existence of relationship between corporate governance and firm performance due to the existence of negative relationship between firm value and agency cost [4].

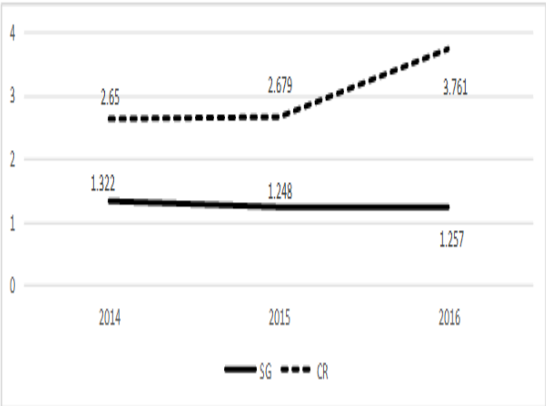

Figure 1. Operating Performance Analysis

[5] quote that corporate governance roles handle in the way that the suppliers of finance to corporations guarantee themselves of getting a return on their investment. This reflects that corporate governance should effectively design and administer the firm policy, strategic decisions and control procedures for a positive future direction of firm Thus, the corporate governance plays an indirect role in the country economic development. The corporate governance mechanism which handles the welfare and goal of all stakeholders has an effect on the way firms are operated [3]. The essentiality of corporate governance involvement is necessary during and after GST implementation. This involvement indicates on the requirement of due diligence and best practices of the corporate governance mechanisms for the wellbeing of firm and all stakeholders. In line with agency theory, [6] emphasize those firms with good practices in corporate governance decrease agency cost and greater performance in accounting and market perspective. Moreover, to the best of knowledge, no studies have investigate the support of corporate governance on operating performance during and after GST implementation. Indeed the outcome should addresses the gap of the roles played by the corporate governance particularly directors and CEO during GST implementation. Thus, this paper proposes to examine the nature of relationship between corporate governance with operating performance during and after GST implementation.

2. Literature Review

The corporate governance handles the separation of ownership and control issues as prescribed in agency theory, the way in which the shareholders receive return from investments and avoid managers' misappropriation of shareholders capital by investing in unhealthy projects [5]. The boards of directors are responsible to firms and shareholders [7]. [8] report that board of directors are advisers to management so that managerial decisions increases shareholder returns. [9] reports that board of directors have the main role in corporate governance with various responsibilities ranging from approval of firm strategy plan, policies development that determines firms direction, appointing and managing higher level of management and assuring firms are accountable to shareholders and other stakeholders. Thus, the directors and Chief Executive Officer (CEO) (board directors) have profound impact to firm performance. Corporate governance is the determination factor for firms' administrative excellence [10]. Consistently, this paper recommends using board size, board independent, women director, CEO age and CEO type as the corporate governance variables to determine their relationship with operating firm performance during and after GST implementation.

2.1. Board size and Operating performance

Board size is defined by number of directors serve in firm's board and is classified as board composition with mix of director types [11]. Study by [6] analyse the corporate governance with firm performance find significant positive relationship between board size and firm performance. The authors further explain that large board with profound intellectual knowledge brings improvement to firms' decision making and positive effect to firm performance. Similarly, [4] report that larger boards with diverse expertise through widen skills and inter link with firms make effective decisions that caused improvement to firm performance.

However, [13] discover that board size is significant and negatively related to firm performance which indicates the existence of disagreement and lack of integration in large board members in comparison to fewer board members. [14] find negative significant relationship between board size and firm performance due to existences of information asymmetry between outside and other directors in the firm. From this relationship, the proposition can be formed:

P1: There is a relationship between board size and operating performance.

2.2. Board independent and Operating performance

The directors are independent when no involvement in firms executive positions, they are classified as outside directors. MCCG (2012) recommends the board to review annually the independent position of outside directors and limit the tenancy period for independent directors to nine years, further the tenure extension through shareholders' approval. [4] describe significant positive relationship between board independent and firm performance (ROA).

The board independent or non-executive directors' expertness, with external links and advising role are essential in profitability of firms. This reflects that non-executive directors an external coach to executive directors and management for sound firm operating performance. [13] identify significant positive relationship between board independent and firm performance (Tobin Q) which reveals on the capabilities, expertise and reasonable experience which increase the firm performance. However, the findings of [6] exhibit negative relationship between board independent and firm performance which reflects on limitation of independence provided to outside directors. The authors report that in some developing countries the same outside directors work as independent directors in other firms' due to limitation in availability of outside directors which possibly lead to existence of biasness in board independent monitoring and judgement skill and influenced by executive directors. [15] studied the relationship between corporate governance and firm performance (earnings per share -EPS) for 20 Malaysian listed firms from year 2006 to 2012. Their study reveals no significant relationship between board independent and firm performance. According to [16] outside directors are occupied with their full-time job so insufficient time involving in firm affairs and insufficient knowledge in firm environment to make decisions. Thus, the CEO channelled the information to the outside directors. This basically reflects that CEO involves more in the day to day operations of the firm business and critical involvement in decision making. This develops to proposition:

P2: There is a relationship between board independent and operating performance.

2.3. Women directors and Operating performance

[17] discover that women directors (gender diversity) influence the effectiveness of the board that gives positive effect to firm decision making, governance quality and firm value. [18] elaborate that women directors have a better board meeting attendance records compared to male directors. In general, the authors report that women directors attend more board meeting compared to male directors and active participation at board and overseeing committee meetings. [19] report that women directors are positively link to firm reputation. [20] study indicates that women director has positive and significant relationship with firm performance (Return on equity -ROE). The author reports that women in management and in board do create sufficient value to maintain an ordinary stock price return.

On the other hand, [20] report the existence of marginally significant negative relationship between women directors and firm performance (Return on asset-ROA) which indicates on negative influence of women directors to firm performance. Further, the authors report that women directors in board are mere representation on the existence of board diversity and as a fulfilment to the needs of stakeholders of having women directors in board. [21] opine that women directors negatively related to firm performance (Tobin Q & ROA). The authors report that this relationship indicates on women directors representation in board provides low firm performance. However, [20] find that senior (age) and with degree qualification women directors have positive impact to firm performance. The women directors with a degree is able apply skill in developing firm policies and strategies to improve firm performance (EPS). The authors report that women directors with ownership in firms is having significant and negative relationship with firm performance (EPS). This is due to small percentage of ownership around 15 percent of ownership failed to place women directors in control of the firm. This develops to proposition:

P3: There is a relationship between women directors and operating performance.

2.4. CEO age and Operating performance

Age of CEO is an essential characteristic in style of leadership and decision making. Consistently age has an essential role in firm decision making [24]. The increasing age and experience of CEO increase in effective management ability, thus, CEO age may have positive impact to firm performance [25]. [21] report that older directors with good experience are better advisors to guide the firms, hence, encouraged to appoint directors who are older in age. This reflects that CEO age has positive impact to firm operating performance. The age of the CEO gains much management experience that leads to firm growth. Depending to firm environmental condition, the CEO age does have significant impact on dynamic marketing and R&D capabilities development [26]. The authors mention that young CEO use dynamic marketing and R&D capabilities compared to older CEO which prefer the less risky approaches that foster existing strategies. Younger directors are more energize and willing to take more risk while older directors seek stableness and prudence to decisions [27]. This supports the [28] study that the connection between youthful management and achieving higher firm growth by ensuring more capable young management in more senior position.

Consistently, [29] study results show negative significant relationship between board members age and firm performance (Tobin Q). The study highlights that younger board members who are innovative and efficient outperform the older board members. Thus, the proposition can be formed:

P4: There is a relationship between CEO age and operating performance

2.5. CEO type and Operating performance

[30] study on the relationship between family CEO and professional CEO with firm performance in Taiwan identify that both family and professional CEO has ability to improve the firm performance as long as good governance system in place and employed by suitable firms. [31] reports that family CEO has positive impact to firm performance. [32] mentions that "family companies prefer to have family CEO to manage the company because of strong family cultures, high sense of family unity and belongings within the companies". On the other hand, [33] highlight that family CEO have significant negative relationship with firm performance. Further, outside directors have reputation, knowledge and managerial experience, thus, private controlled and family firms benefits from the outside directors appointment [33]. Thus, which type of CEO is better needs to be investigated particularly during implementation of new financial/ tax policy that requires changes in business process. This develops to proposition:

P5: There is a relationship between CEO type and operating performance

3. Methodology

This conceptual paper is solely based on the review of literature of corporate governance and operating performance to confirm on the nature of their relationship. However it is essential to conduct an empirical study in future. For the confirmation of the five propositions, this paper shall proceed to use quantitative research design to identify the nature of relationship between corporate governance and operating performance during and after GST implementation. The 265 Malaysian listed firms data to be collected from the audited annual report during and after GST implementation accessed from Bursa Malaysia website from year 2015 to 2016. This paper proposes to utilize ordinary leased squares (OLS) regression to determine the relationship between the operating performance (sales growth and current ratio) with the corporate governance during and after GST implementation. With this, the empirical results shall reflect on the role played by the 5 corporate governance variables in reviving and maintaining the operating performance during GST implementation.

4. Discussion & Conclusion

Basically limited studies focus on the link between operating performance and corporate governance. From seeing the operating performance of the firms in year 2015 and 2016, indicate that firms have shown their commitment and move forward in sustaining their operating performance even with the GST implementation. These firms should be supported by the strong corporate governance.

However, there is a need for empirical evidence to strengthen this statement. This paper highlights on the requirement to determine the nature of relationship between corporate governance with operating performance particularly during and after GST implementation. The outcome shall witness on the involvement of those charge with governance for thriving to embed and adopt GST system in business processes. Therefore, a strong corporate governance involvement is necessary during and after GST implementation. With the guide of agency theory, this paper develops five propositions for the relationship between corporate governance and operating performance during and after GST implementation. Specifically, this paper emphasize on the importance and involvement of corporate governance during implementation of any new policy that require changes or strengthening on the business processes. The governance involvement shall accord for firm value and shareholders wealth maximization that ultimately contribute to country economic development and nation building particularly during the GST system implementation period.

References

[1] L. Ebrill, M. Keen, J. P. Bodin, and V. Summers, "The allure of the value-added tax," *Financ. Dev*., 2002.

[2] N. Hafizah, A. Mansor, and A. Ilias, "Goods and Services Tax (GST): A New Tax Reform in Malaysia," *Int. J. Econ. Bus. Manag. Stud. -IJEBMS ISSN Int. J. Econ. Bus. Manag. Stud*., 2013.

[3] H. Sami, J. Wang, and H. Zhou, "Corporate governance and operating performance of Chinese listed firms," *J. Int. Accounting, Audit. Tax.*, 2011.

[4] J. Abor and N. Biekpe, "Corporate governance, ownership structure and performance of SMEs in Ghana: Implications for financing opportunities," *Corp. Gov*., 2007.

[5] A. Shleifer and R. W. Vishny, "A Survey of corporate governance," *J. Finance*, 1997.

[6] A. Arora and C. Sharma, "Corporate governance and firm performance in developing countries: evidence from India," *Corp. Gov*., 2016.

[7] O. for E. C.-O. and Development, "OECD Principles of Corporate Governance," 1999. [Online]. Available http://www.oecd.org/officialdocuments/public displaydocumentpdf/?cote=C/MIN(99)6&doc Language=En.

[8] T. Sitthipongpanich and P. Polsiri, "Who's on board? Influence of diversity and network of Thai boards of directors on firm value," *J. Appl. Bus. Res*., 2013.

[9] C. H. Ponnu, "Corporate Governance Structures and the Performance of Malaysian Public Listed Companies," *Int. Rev. Bus. Res. Pap*., 2008.

[10] E. L. Mendes-da-Silva, W., & Black, "Corporate governance, strategy, and supply management performance: an empirical analysis of companies listed in the São Paulo Stock Exchange.," *Int'l L. Mgmt. Rev*., vol. 2, p. 43, 2005.

[11] S. A. Zahra and J. A. Pearce, "Boards of Directors and Corporate Financial Performance: A Review and Integrative Model," *J. Manage*., 1989.

[12] "Malaysian Code of Corporate Governance." [Online]. Available: https://corporategovernancemalaysia.wordpress.com/2012/05/16/mccg-2007-part-iibest-practices-in-corporate-governance/.[Accessed: 16-May-2012]

[13] M. S. Malik, D. D. Makhdoom, D. Debaj, M. Muhammad, and S. Malik, "Corporate Governance Does corporate governance beget firm performance in Fortune Global 500 companies? Does corporate governance beget firm performance in Fortune Global 500 companies?" *Fortune Glob. Corp. Gov*., 2017.

[14] A. Rashid, A. De Zoysa, S. Lodh, and K. Rudkin, "Board Composition and Firm Performance : Evidence from Bangladesh," *Australas. Account. Bus. Financ. J.*, 2010.

[15] D. F. Marn, J. T. K., & Romuald, "The impact of corporate governance mechanism and corporate performance: A study of listed companies in Malaysia.," *J. Adv. Sci. arts,* vol. 3, no. 1, pp. 31–45, 2012.

[16] K. S. Rebeiz, "Boardroom's independence and corporate performance: the ever-elusive conundrum.," *Corp. Gov.*, vol. 15, no. 5, pp. 747–758, 2015.

[17] M. E. Lucas-Pérez, A. Mínguez-Vera, J. S. Baixauli-Soler, J. F. Martín-Ugedo, and G. Sánchez-Marín, "Women on the Board and Managers' Pay: Evidence from Spain," *J. Bus. Ethics*, 2015.

[18] R. B. Adams and D. Ferreira, "Women in the boardroom and their impact on governance and performance," *J. financ. econ.*, 2009.

[19] F. Bravo, C. Abad, and J. L. Briones, "The board of directors and corporate reputation: an empirical analysis," *Acad. Rev. Latinoam. Adm.*, 2015.

[20] R. Amran, N. A., Manaf, A., Bahrain, K., & Ishak, "Gender Diversity: Does 'Relationship'Jeopardise Performance?," *Adv. Sci. Lett.*, vol. 21, no. 5, pp. 1497–1500, 2015.

[21] S. N. Abdullah and K. N. I. K. Ismail, "Gender, ethnic and age diversity of the boards of large Malaysian firms and performance," *J. Pengur.*, 2013.

[22] G. A. Afrifa and V. Tauringana, "Corporate governance and performance of UK listed small and medium enterprises," *Corp. Gov.*, 2015.

[23] E. M. Al-Matari, A. K. Al-Swidi, F. H. Fadzil, and Y. A. Al-Matari, "The Impact of board characteristics on Firm Performance: Evidence from Nonfinancial Listed Companies in Kuwaiti Stock Exchange," *Int. J. Account. Financ. Report.*, 2012.

[24] D. K. Tarus and F. Aime, "Board demographic diversity, Firm performance and strategic change a test of moderation," *Manag. Res. Rev.*, 2014.

[25] Z. Xiao, R. He, Z. Lin, and H. Elkins, "CEO compensation in China: Accounting performance, corporate governance, and the gender gap," *Nankai Bus. Rev. Int.*, 2013.

[26] M. Rodenbach and M. Brettel, "CEO experience as micro-level origin of dynamic capabilities," *Manag. Decis.*, 2012.

[27] R. C. Anderson, D. M. Reeb, A. Upadhyay, and W. Zhao, "The Economics of Director Heterogeneity," *Financ. Manag.*, 2011.

[28] J. Child, "Managerial and organizational factors associated with company performance," *J. Manag. Stud.*, 1974.

[29] C. Rose, "The composition of semi-two-tier corporate boards and firm performance," in *Corporate Governance: An International Review*, 2005.

[30] S. H. Lin and S. Y. Hu, "A family member or professional management? the choice of a CEO and its impact on performance," *Corp. Gov. An Int. Rev.*, 2007.

[31] Noor Afza Amran and A. C. Ahmad, "Corporate governance mechanisms and performance: Analysis of Malaysian family and non-family controlled companies," *J. Mod. Account. Audit.*, 2010.

[32] N. A. Amran, "CEO Succession: Choosing Between Family Member or Outsider?," *Asian J. Financ. Account.*, 2012.

[33] C. Pombo and L. H. Gutiérrez, "Outside directors, board interlocks and firm performance: Empirical evidence from Colombian business groups," *J. Econ. Bus.*, 2011.