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Board Governance and Share Repurchase in Malaysia: A Panel Data Analysis of Malaysian Public Listed Companies

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ABSTRACT

This study presents the impact of board governance mechanism on share repurchase for Malaysian listed companies by using the pooled panel data analysis for a period of six years (2005 to 2010). The result shows that foreign board member, board independent and total remuneration play a significant role in influencing Malaysian companies toward share repurchase.

Introduction

Share repurchase or stock buyback was actively taken place around 14 years ago after the Malaysian stock market was seriously being hit by the Asian Financial crisis in 1997. After the collapse of stock market, share repurchase was executed as part of the strategy to gain back investors' confidence. In fact, share repurchase would drive up share prices and decrease the number of shares outstanding (Nadarajan et al., 2009). By allowing companies to exercise buyback on their shares, investors would receive capital gains that would give them options to either reinvest in the same company or shift their investment in other companies. Firms would normally buy back shares when their share prices are perceived to be undervalued.

From the legal aspect, with proper application, public-listed companies in Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange (KLSE) are allowed to buy back their own shares as stipulated under Section 67A of the Companies (Amendment) Act 1997, with proper application, As for disclosure, the Malaysian Accounting Standard Board (MASB) in April 1999, through a circular on 'share-buyback accounting and disclosure' spell out that companies that are engaged in repurchasing their own shares should report all such transactions in their financial statements.

In the U.S, share repurchase took off two decades ago in the mid-1980s. Many American companies rely on share repurchase as a payout method instead of dividend payment. This causes the value of shares repurchased exceeded the value of dividends for the first time in the late 1990s (Fried, 2005). In 1980, the U.S share repurchase was valued at $6.6 billion and it substantially grew to almost $2000 billion in 2003 (Grullon and Ikenberry, 2000).

Based on Table 1, it can be observed that there is generally an increasing trend of share repurchase among public-listed companies in Bursa Malaysia. Share repurchase started to grow in 2001 and continued to increase with the highest was recorded in 2008 involving 204 companies.

Table 1. Share Repurchase in Bursa Malaysia between1999 and 2009

Year	Total number of companies
1999	12
2000	13
2001	26
2002	32
2003	62
2004	70
2005	127
2006	145
2007	154*
2008	204*
2009	196*

Source: Ramakrishnan, Ranindran and Ganesan, 2007
*The Star January 30, 2010**

The practice of share repurchase in Malaysia has to do with various purposes particularly for employee option plans in which reissue or redemption is without having a time limit (Sabri, 2003). In the presence of executive stock options plans, there is a lesser likelihood of payout in the form of dividends (De Jong et al., 2003).

Issue of corporate governance has been an area of concern during the Asian financial crisis in 1997. In strengthening its corporate governance system, Malaysia has taken several initiatives covering many aspects of governance including the role of board directors. This can be seen through the introduction of the Directors Code of Ethics, establishment of Malaysian Code of Corporate Governance containing the element of board structure and composition; and guidelines on listing requirements which also linked the board of directors with respect to integrity and public accountability.

Based on the above discussion, it is therefore interesting to examine the growing activities of share repurchase in Malaysia in the context of the role of the corporate governance through board of directors. This study gives insight into corporate financial policy with respect to payout policy of Malaysia firms that provide policy makers bases for formulating policy concerning corporate governance and payout policies.

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Literature Review

Board Size

By examining the factors that influence buyback decision, Yarram (2013) finds board characteristics such as board size, independence and duality are insignificant in influencing buyback decision in non-financial Australian firms for the period 2004 to 2010. As mentioned in the literature, too many directors serving on a board may increase agency problem since the directors are becoming less effective in monitoring the managers (Bozec and Dia, 2007). With the existence of free-rider problem couple with lesser time to monitor the management and higher agency conflict, there'll be higher payout. In comparison, a smaller board may be more effective in monitoring members, speed up company's decision making and limit directors' incentives to shirk (Haniffa and Hudaib, 2006). With reduced agency conflict, it leads the firm to pay lower payout on repurchase. Consequently, board size will be positively correlated to dividend decisions (Yermack, 1996; Byoun et al., 2011; Sulong and Ahmed, 2011). Thus, the hypothesis is:

H_1: There is a positive relationship between board size and share repurchase.

Foreign Board

Foreign board membership is a part of an internal corporate governance mechanism in determining firm value and the allocation of resources among various stakeholders (Oxelheim and Randoy, 2003). They suggest that firms should include foreign board membership as a "step" forward in the globalization process. It can also help the board to emphasize more on truth and frankness in serving all shareholders, instead of giving priority to politeness and courtesy among board members. It is also stated that the value of firms increases when they incorporate foreigners into their board of directors. The value of firm increases because they are more focus to assist their companies in monitoring the management thus improving their firms' performance.Foreign board members are also more independent compared to local board members since they may have less stake in the capital invested in local market. Thus, with their knowledge and skills, they are more focused in helping the management to reduce risk when competing in local and global markets. Agency conflict is less likely to take place with foreign board members. With the low possibility of agency conflict, foreign board member will be negatively related to payout (dividend and share repurchase) decision. Therefore, the hypothesis is:

H_2: There is a negative relationship between foreign board member and share repurchase.

Board Independence

How et al. (2008) and Sulong and Mat Nor, (2010) indicate that firms with high level of board independent have lesser payout. When a company has more outside board members, they are more concern on how to increase firm performance and will decide to pay low dividends to shareholders (Bathala and Roa, 1995; How et al., 2008; Jo and Pan, 2009). The higher the number of outside directors sitting on the board, the stronger the corporate governance of the firm will be (Weisbach, 1988). The independent directors authorize only repurchase that can enhance the shareholder value (Del Guercio et al, 2003). A company with greater board independence can improve its internal monitoring and able to discipline the management. This may result reduced agency conflict and therefore decreasing total payout (Sharma, 2011). Thus, the lower payout leads to the following hypothesis:

H_3: There is a negative relationship between board independence and share repurchase.

CEO Remuneration

Managers might prefer to link their compensation to the firm's payout if they privately know about the optimal payout (Chang, 1993). According to Bhattacharyya et al. (2008), compensation is one of the methods that can be used by shareholders to encourage managers to retain and invest the available earnings in positive NPV projects. To some extent, when managers are able to decide on profitable projects, any leftover earnings can be distributed as payout. There will be a negative relationship between CEO remuneration and payout decision. Thus, the hypothesis is:

H_4: There is a negative relationship between CEO remuneration and share repurchase.

Methodology

This research uses the annual report of companies listed on the main board of Kuala Lumpur Stock Exchange (Bursa Malaysia) from 2005 to 2010 to collect information on board size, board independent, board nationality, compensation, and voting right. On the other hand, data from Datastream is used to collect other financial information including Return on Equity (ROE), Market-to-Book Equity Ratio (MTBV), Firm Size (FZ) and Debt to Equity Ratio (LEV). Previous studies indicate that these are considered as control variables in a study involving share repurchase.

From the original population, companies which do not have complete data, financial institutions, disposed off or taken over, and under PN4 and PN17 during the period of study will be excluded from the sample. During the period under study, out of 682 companies in the Main Board, there were 327 companies with complete data on total payout. We only take into account companies that have complete data on share repurchase during the period of the study. Thus, finally only 71 companies are examined.

Pooled panel regression analysis is used to measure the relationship of all the variables with the share repurchase with 426 observations.

$$Y_{it} = \beta_0 + \beta_1 X_{it} + \beta_2 X_{it} + \dots + \beta_n X_{it} + \varepsilon_{it} \quad (1)$$

Where *i* denotes the firm (cross section dimension) and *t* denotes time (time series dimension). Therefore, Y_{it} is the dependent variable of pooling *N* cross sectional observations and *T* time series observations, and X_{it} s are the independent variables pooling *N* cross sectional observations and *T* time series observations. B_0 is the constant term or intercept across cross sectional observations, and ε_{it} is the error term.

The empirical model used in this study can be described as follows:

Model 1:

$$SR_i = \beta_0 + \beta_1 BZ + \beta_2 FBM + \beta_3 BI + \beta_4 TR + \beta_5 MTBV + \beta_6 RK + \beta_7 ROE + \beta_8 FZ + \beta_9 LEV + \beta_{10} AGE + \varepsilon_{it} \quad (2)$$

Where; β_0 = constant term; *SR* = Share Repurchase for firm i; Board Governance Variables: *BZ* = Board size; *FBM* = Foreign Board Members; *BI* = Board Independence and *TR* = Total Remuneration. *MTBV* = Market-to-Book Equity Ratio; *ROE* = Return on Equity; *FZ* = Firm Size; *LEV* = Leverage; *AGE* = Firm Age.

Further description of the variables is included in Table 2.

Findings

Descriptive Statistics

Table 3 presents the descriptive statistics for variables used in the study for a period of 2005 to 2010. On average, during this 6-year period, share repurchase records RM16,192,723 in total payout with maximum payout at RM108 million and minimum at RM81. The lowest share repurchase is recorded from YTL Land & Development Bhd, where in year 2006 the company buy back 100 shares at price RM0.8103. Malaysian companies listed on the Main Board have approximately an average of eight directors on their board which is consistent with earlier findings by Lipton and Lorsch (1992), Bokpin and Arko (2009) and Sulong and Mat Nor (2010).

Table 2: Description of Variables

Variables	**Authors**
Share Repurchase (SR) Log (Total amount paid to repurchase shares)	Oswald and Young (2004); Eije and Megginson (2008)
Board Size (BZ) The total number of directors on the board	Linck et al. (2008); Jackling and Johl (2009); He et al. (2012).
Foreign board member (FBM) Dummy 1 if board members are foreigners, otherwise 0	Gulamhussen and Guerreiro (2008); Choi et al. (2012)
Board Independence (BI) The percentage of independent directors in the firm	Pathan (2009); Sulong and Mat Nor (2010); He et al. (2012).
Total remuneration (TR) Log (total remuneration per year)	Heaney et al. (2010); Shiwakoti (2012)
Market-to-book equity ratio (MTBV) = Market value of equity / Book value of equity	Skinner (2008); Linck (2008); Adjaoud and Ben-Amar (2010).
Risk (RK) Dummy 1 if BBB and above, 0 otherwise.	Guedes and Opler (1996); Opler et al. (1999).
Profitability Return on Equity (ROE) = Net Income / Shareholder Equity	Ling et al. (2008); Chay and Suh (2009)
Firm Size (FZ) The logarithm of total assets	Jiraporn (2006); Ahmed and Javid (2009);
Leverage (Lev) Debt to Equity Ratio	Sanders and Carpenter (2003).
Firm Age (Age) The logarithm of listing age	Linck et al. (2008); Sulong and Ahmed (2011)

Other than that, on average, the number of foreigners on a board is 1 member with the highest is 6 members. Furthermore, in terms of board independence (BI) on average there are 3 independent directors with the highest being 7 independent directors sitting on the company board. This is consistent with the Bursa Malaysia Listing Requirement (2001) which requires that at least two directors or one-third of the board of directors to be represented by independent directors. Meanwhile, the highest total remuneration received by a CEO during the period of study is RM58 million with an average of RM4,149,441.

As for Market-to-Book Equity value (MTBV), the average (median) is 1.22 percent (0.86 percent) with 25.72 percent being the highest. Looking at companies' profitability, it showed on average (median) percentage of return on equity (ROE) of 9.83 percent (9.94 percent), with as high as 74.71 percent profitability. However, during this time leverage is very high at 376.46 percent and the overall average is 55.91 percent. As for the age of firm listed in Bursa Malaysia, the oldest is 47.34 years with an average of approximately 16 years.

Table 3: Descriptive Statistics

Variables	Mean	Median	Maximum	Minimum	Standard Deviation
SR (RM)	16,192,723	1,345,524	108,000,000	81.00	85,329,362
BZ (No)	8.03	8.00	15.00	4.00	2.06
FBM (No)	0.49	0.00	6.00	0.00	1.09
BI (No)	3.27	3.00	7.00	1.00	0.89
TR (RM)	4,149,441	2,495,599	58,271,353	263,933	6,449,154
MTBV	1.22	0.86	25.72	(38.57)	2.79
RK	0.13	0.00	1.00	0.00	0.34
ROE (%)	9.83	9.94	74.71	(52.66)	10.28
FZ	8.91	8.81	12.46	6.18	0.64
LEV (%)	55.91	34.44	376.46	0.00	65.34
AGE (Year)	16.10	12.93	47.34	0.41	10.24

Regression Analysis

Table 4 reports the regression results of board governance and share repurchase with F-statistic which is significant at 1 percent level. Board size is insignificant in relation to share repurchase, hence H_1 is rejected. However, this result is consistent with the research made by Yarram (2013) where in Australia board size is not related to repurchase decision. Additionally foreign board member, *FBM*, board independence, *BI*, and total remuneration play a significant role in influencing Malaysian companies toward deciding on share repurchase. Hypothesis H_2 is accepted; there is a negative relationship between foreign board members and share repurchase. According to Oxelheim and Randoy, (2003), a company with foreign board member is able to enhance the firm's reputation and value in the financial market. By having at least one foreign member on the board, it is a signal of company's greater commitment in corporate monitoring and transparency that eventually reducing agency conflict and total payout. On top of that, companies with high board independence are able to monitor and discipline the management and the probability of the managers being entrenched is low. Entrenched managers are more likely to favor in distributing money either in terms of dividend payment or share repurchase. Thus, when a company has more outside board members, they are more concern on how to increase firm performance and will decide to pay low payout to shareholders (Bathala and Roa, 1995; How et al., 2008; Jo and Pan, 2009). It leads to the acceptance of H_3 where there is a negative relationship between share repurchase and board independence.

Table 4:
Panel Regression Result on Share Repurchase

Independent Variable	**Coeff**	**S.E**
CONSTANT	-1.040	1.239
BZ	0.006	0.036
FBM	-0.654***	0.145
BI	-0.009*	0.006
TR	0.454**	0.191
MTBV	-0.026	0.022
RK	-0.042	0.189
ROE	0.008	0.006
FZ	0.481***	0.119
LEV	0.000	0.001
AGE	0.059	0.216
R^2	0.158	
Adjusted R^2	0.137	
F-Statistics	7.802***	
DW	1.09	

****, **, * indicate significance at the 1%, 5 % and 10% levels*

CEO remuneration has positive significant relationship to share repurchase at 5 percent significant level, thus H_4 is rejected. The result suggests that top executive or CEO positively expect their total remuneration to increase when they care more on the shareholders' wealth. CEO remuneration and payout policy move in tandem, where the CEO can expect to receive higher remuneration by distributing dividends to shareholders (Lewellen et al., 1987). Likewise, large Malaysian companies tend to choose share repurchase as a method of payout. Larger firms can afford to pay higher payout compared to smaller firms since they have easier access to external financing in the capital market (Holden et al., 1998 and Eije and Megginson, 2007). As for control variables, leverage, profit, age, risk, and market to book value are insignificant to influence company decision on share repurchase matters.

Conclusions

This paper utilizes the corporate governance mechanism namely board governance, compensation and types of ownership structure towards Malaysian companies share repurchase decision. This was done for a period of six years (2005 to 2010). In contrast to the majority of prior studies regarding company payout method, most of them are mainly focusing on dividend payment instead of share repurchase. With the current trend and development of share repurchase, this paper utilizes 71 companies or 426 observations from Bursa Malaysia. Among all board governance mechanisms in Malaysia, foreign board member and board independence have the most influence in companies' share repurchase decision. The results concludes the role of foreign and independent board in reducing agency conflict that probably reduced the total payout inclusive of share repurchase among listed companies in Malaysia.

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