*International Journal of Academic Research in Business and Social Sciences*
*2017, Vol. 7, No. 2*
*ISSN: 2222-6990*

# The Board Governance Mechanism and the Effect of Concentration Ownership on Malaysia Companies Performance

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DOI: 10.6007/IJARBSS/v7-i2/2684 URL: http://dx.doi.org/10.6007/IJARBSS/v7-i2/2684

**Abstract**

Malaysian Code of Corporate Governance (MCCG) had provide a standard guideline for the companies to strengthen the boards of directors accountabilities and transparent in disclosing their financial information to the shareholders. Numerous studies have been done to studies the relationship between corporate governance and performance but the result still inconclusive. This study aim to identify the effect of moderator proxy by concentration ownership would strengthen the relationship between Board Governance Mechanism Index (BGMI) and performance proxy by Tobin Q of Malaysian companies listed on Bursa Malaysia. Data were gathered from 218 Malaysian public listed companies started from 2009 until 2013 using the STATA in testing the research hypotheses. There were six dimension of corporate governance mechanism index matters were developed in this study by adopting and adapting the Corporate Governance Index and governance scorecard developed by Minority shareholders Watchdog Group (MSWG) in 2009 and 2012 including some of the items selected under the MCCG 2008 and MCCG 2012. The result obtained will determining the existent of ownership concentration would be one of the factors that influence the relationship between corporate governance and performance of Malaysian company.

**Keywords**: Corporate Governance, Performance, Ownership, Malaysian

## Introduction

Corporate governance had been strong predictor in evaluating the company performance, mainly due to the mandatory and obligation practices prescribed by the government to raise the standard of good governance momentum among the companies board of directors. The boards of directors are those who are responsible to sustain the momentum of corporate governance practices in the company for the sake of the shareholders wealth and continuous improvement of the company performance. The performance of the company is not rely on the investment return only but also through the way the directors governing and implementing the corporate governance system in their company. In order to achieve a high standard of corporate governance, the board of directors and management team need to mitigate the agency problem. There were several ways to reduce the agency problem and strengthen the level of responsibility and accountability among the directors in the companies. Past researchers found that monitoring cost, restriction of law in corporate governance implementation, influence of political patronage and ownership structure concentration were some of the indicators used to identify the relationship between corporate governance and company performance (Rashidah, 2006). A good corporate governance mechanism developed required a full commitment from the board of directors and management team. In order to attract the board of directors and management team commitment, the company needs to change from wide dispersion of ownership to concentration of ownership structure, where the voting and controlling power lies in the hand of controlling shareholders. Therefore for the purpose of this study, we will investigate the effect of concentration ownership structure on the relationship between the Board Governance Mechanism Index (BGMI) and firm performance of Malaysian Listed Companies in Malaysia.

**Problem Statement**

Securities Commission (SC) as a monitoring body regulates and promoting the development of the securities of future capital market in Malaysia had developed first Malaysia Code on Corporate Governance in 2000 (MCCG ,2000) as a stepping stone for Corporate Governance reform in Malaysia . Later the code was revised in 2007 to strengthen the roles and responsibilities of the BOD, audit committee and the internal audit functions. In the year 2012 SC again release a new MCCG 2012 superceded the MCCG 2007 focuses on strengthening the board structure and board composition in recognizing the role of directors as active and responsible fiduciaries (Securities Commission Malaysia, 2012). There were new principles and recommendations introduced in MCCG 2012 compare to MCCG 2007. The new MCCG 2012 provide a strong foundation improving the roles and responsibilities of the board and the committee members for them to seriously play their part effectively including promote timely disclosure of financial reporting safeguarding the integrity and transparency of the company information and strengthening the internal control (Crowe & International, 2012). The changes made in MCCG 2012 required the board of directors to upgrade their current governance policies which required time and effort. The MCCG 2012 takes effect on 31 December 2012. Companies with financial year end on 21 December 2012 should made the changes relation to new MCCG 2012 in the annual report published in 2013 (PwC, 2012).

Theoretically we can see that the development of the new MCCG 2012 increase the level of internal governance of the companies but the fact is the changes required time and effort from all the board of the companies and the management team.

Table 1 *New Recommendation in MCCG 2012*

| | Principles | MCCG 2012 |
|---|---|---|
| 1. | Establish clear roles and responsibilities | The board should formalize ethical standards through a code of conduct and ensure its compliance |
| | | The board should ensure that the company's strategies promote sustainability |
| | | The board should formalise, periodically review and make public its board charter |
| 2. | Reinforce independence | The board should undertake an assessment of its independent directors annually |
| | | The tenure of an independent director should not exceed a cumulative term of nine years. Upon completion of the nine years, the independent director may continue to serve on the board subject to the director's re-designation as a non-independent director |
| | | The board must justify and seek shareholders' approval in the event it retains as an independent director, a person who has served in that capacity for more than nine years |
| 3. | Foster commitment | The board should set out expectations on time commitment for its members and protocols for accepting new directorships |
| | | The board should ensure its members have access to appropriate continuing education programme |
| 4. | Uphold integrity in financial reporting | The Audit Committee should have policies and procedures to assess the suitability and independence of external auditors |
| 5. | Ensure timely and high quality disclosure | The board should ensure the company has appropriate corporate disclosure policies and procedures |
| | | The board should encourage the company to leverage on information technology for effective dissemination of information |
| 6. | Strengthen relationship between company and shareholders | The board should encourage poll voting |

Previous empirical studies presented a mixed result on the relationship between corporate governance and company performance. The never ending journeys in corporate governance researches motivate researchers to continue searching for the best finding related to corporate governance and company performance.

In Malaysia several studies on corporate governance and performance have been conducted previously. Based on the studies done by found Roszaini & Muhammad (2006), Haat, Rahman, & Mahenthiran (2008) that CG practices benefit the company performance and protect the shareholders wealth. However a study done by Anum & Ghazali (2010) showed that none of the corporate governance variables was statistically significant in explaining corporate performance. San, Boon, Ahmad, & Muhamad (2015) who studies Malaysian companies also found that several corporate governance variables did not have any significant impact on

performance. The inconsistency finding of corporate governance issues not only in Malaysia but other Asian countries also faced the same problem clarifying the corporate governance issues.
Due to this scenario, some researchers started to search for other key driver that can strengthen the board structure and board composition of the company besides monitoring the roles and responsibilities of the board of directors' activities in governing the companies. Rashidah, (2006) claimed there are various factors influence the relationship between corporate governance and performance such as monitoring cost, restriction of law in corporate governance implementation, influence of political patronage and ownership structure concentration. However ownership structure concentration seem be one of the factors that might influence the relationship between corporate governance and performance since it work as monitoring tool that can help to reduce the agency problem and improve the company performance.
Studies done by Manawaduge & Rudkin (2009), Wiwattanakantang (2001) and Tam & Tan, (2007a) found ownership structures have been directly tested with performance and produce inconclusive result. Manawaduge & Rudkin (2009) study found that ownership concentration using HERF have no significant effect on performance proxy by ROA, Tobin Q and ROE. However the 10 largest shareholders show significant weak positive relation with ROA only. Wiwattanakantang (2001) find that ownership concentration is positively related to firm performance in Thai- land and Asia. Such a relationship is especially pronounced in countries where investor protection is low because ownership concentration is found to mitigate conflicts between owners and managers. Tam & Tan (2007a) who studied on top 150 Malaysian public sectors companies found that concentration ownership have significant positive relationship with performance of all sectors in Malaysia
Generally speaking, theoretical and empirical researchers found that ownership –performance relationship had been discussed continuously without any conclusive findings explaining the probable possible explanations between theory and empirical evidence but a few of them analyze the existent of ownership structure as a moderator to enhance the relationship between corporate governance especially the Malaysian past researches who are well verse with the direct relationship between corporate governance and performance such as by Manawaduge & Rudkin (2009) and Wiwattanakantang (2001) and Tam & Tan (2007a)
Therefore this study will investigate the effect of concentration ownership structure on the relationship between the board governance mechanism index and firm performance of Malaysian Listed Companies in Malaysia.

**2.1 Research Objectives**

The purpose for carrying out this research is to:

i. To examine the level of governance mechanism Index (BGMI) made by Malaysian Public Listed company for the year ended 2009 until 2013
ii. To investigate the relationship between governance mechanism Index (BGMI) and performance of Malaysian Listed companies for the year ended 2009 until 2013
iii. To examine the influence of concentration ownership structure as a moderating variable on the relationship between the board of directors governance

mechanism and performance of Malaysian Listed companies for the year ended 2009 until 2013

### 2.2 Research Question

There are three research questions raised by the problems discussed in the previous section:

i. What is the level of board governance mechanism indexes made by Malaysian Public Listed company for the year ended 2009 until 2013
ii. What is the relationship between the board governance mechanism Index (BGMI) and performance of Malaysian Listed companies.
iii. Does the concentration ownership structure will moderate the relationship between the board directors' governance mechanism and performance of Malaysian Listed companies?

## 3. Literature Review

3.1 Board Governance Mechanism and Performan

The companies that have implemented a high quality corporate governance practices will experienced a vigorous growth and grasped more capital to lubricate the economy(Sheikh & Wang, 2012). Good corporate governance must seriously be implemented because as mention by Jacob (2011) in his keynote address at Malaysia Governance Index 2011 in Asia Capital Forum in Kuala Lumpur:

> "*Corporate Governance is a journey, not a destination; it requires continuous monitoring and periodic adjustment to ensure that international corporate governance standards and best practices are adhered to. This will also help Malaysia remain an attractive destination for investment capital needed to sustain economic growth and launch it into the rank of high income economies for the benefit of all Malaysian"* (Jacob, 2011) [1]

In Malaysia several studies on corporate governance and performance have been conducted previously. Based on the studies done by Samad (2004) and Rashidah and Norma (2009) found that CG practices benefit the company performance and protect the shareholders wealth. However a study done by Anum & Ghazali (2010) using the data from the year 2001 annual reports of 87 non-financial listed companies in Malaysia, showed that none of the corporate governance variables was statistically significant in explaining corporate performance. Leng (2004) who studies Malaysian companies from the year 1996-1999 also found that several corporate governance variables did not have any significant impact on performance. The inconsistency finding of corporate governance issues not only in Malaysia but other Asian countries also faced the same problem clarifying the corporate governance issues.

Due to this scenario, some researchers started to search for other key driver that can strengthen the board structure and board composition of the company besides monitoring the roles and responsibilities of the board of directors' activities in governing the companies. Rashidah, (2006) claimed there are various factors influence the relationship between

[1]Jacob Dungau Sagan Deputy Ministers of International Trade and Industry keynote address at Malaysia Governance Index 2011 in Asia Capital Forum funded by Asian Development Bank in Kuala Lumpur

corporate governance and performance such as monitoring cost, restriction of law in corporate governance implementation, influence of political patronage and ownership structure concentration.

Malaysian business environment were claimed to have high ownership concentration around 31% of companies shareholding were whole by single largest shareholder and 62% were hold by five largest shareholders (Roszaini & Muhammad, 2006). Before Muhammad Hudaib and Roszaini Haniffa (2006) studies, La Porta et al. (1998) and Claessens et al. (1999) conducted studies of corporate ownership across East Asia and found 54% of ten largest Malaysian companies' shareholding were hold by the three largest shareholders. Wiwattanakantang (2001) and Lemmon & Lins (2003) find that ownership concentration is positively related to firm performance in Thai- land and Asia especially for the countries where investor protection is low because ownership concentration is found to mitigate conflicts between owners and managers. An empirical studies done by Manawaduge & Rudkin (2009) on the ownership concentration with performance of 45 Sri Lankan listed companies using percentage of 10 largest shareholding and the Herfindahl Index (HERF) found that ownership concentration using HERF have no significant effect on performance proxy by ROA, Tobin Q and ROE. However the 10 largest shareholders show significant weak positive relation with ROA only. Tam & Tan (2007) who studies top 150 Malaysian public listed companies in the year 1990 found that ownership concentration is negatively related to performance (Tam & Tan, 2007b) when the company adopting CEO-duality. A strong domination of highly concentrated ownership structure one of the key determinants of corporate governance which have negative and positive impact to the company (Schleifer and Vishny , 1997). Positively it benefit the minority shareholders because their power and control can prevent the board of directors and management team from misused the shareholders wealth but negatively this controlling shareholders may also pursue their owned interest for their owned benefits making minority shareholders powerless in decision making (Schleifer and Vishny , 1997). Generally speaking, theoretical and empirical researchers found that ownership –performance relationship had been discussed continuously without any conclusive findings same to the finding of the corporate governance and performance.

The previous studies mentioned above explaining the probable possible explanations between theory and empirical evidence but a few of them analyze the existent of ownership structure as a moderator to enhance the relationship between corporate governance especially the Malaysian past researches who are well verse with the direct relationship between corporate governance and performance such as Kamardin &Haron (2011), Kim (2010) and Haat, Rahman, & Mahenthiran (2008). There was a necessities for further investigation to explore the existent of ownership structure concentration as one of the factors that might influence the relationship between corporate governance and performance since it work as monitoring tool that can help to reduce the agency problem and improve the company performance. Thus, this study intends to look into the influences of ownership concentration in enhancing the relationship between board governance mechanism (BGM) and performance. This paper predicts that ownership concentration will moderate the relationship between BGM and performance.

### 3.4 The Proposed Conceptual Framework of the Study

Based on the past literature, the following conceptual framework was developed below:

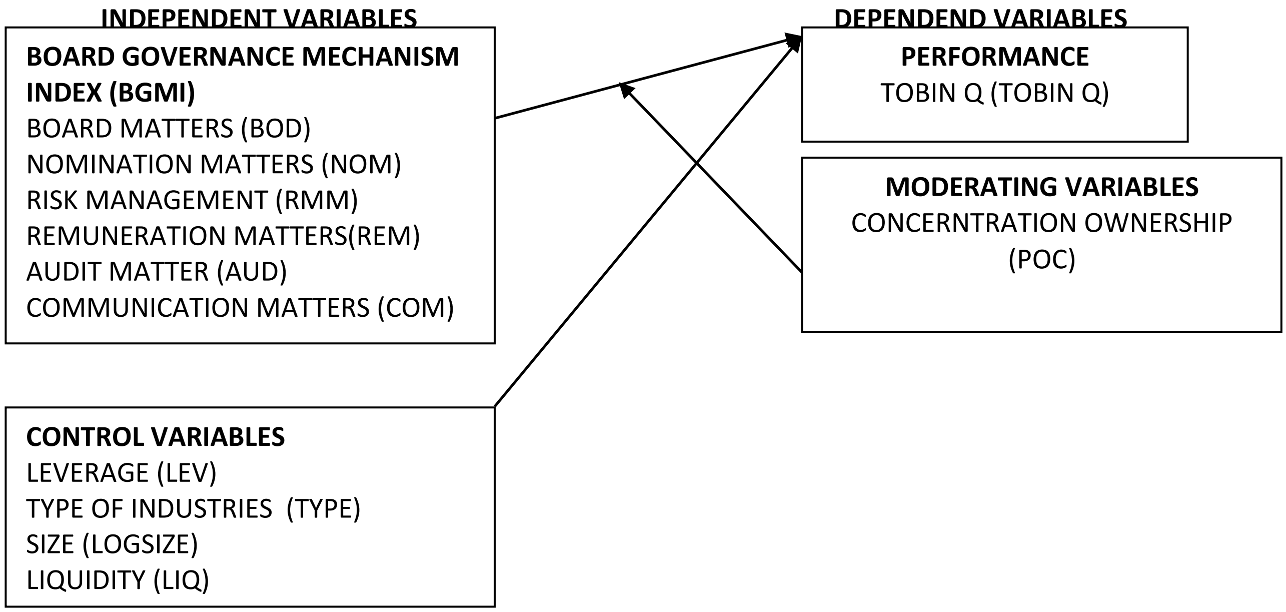


*Figure 1*: Conceptual Model of the Study

### 3.5 *Board Governance Mechanism Index And Performance Hypotheses*

Samad (2004) and Rashidah (2006) explained the positive impact of CG practices benefit the company performance and protect the shareholders wealth. The effectiveness of governance system in the company relied in the hand of the Board of Directors and the management team. The development of corporate governance index in past literature showed an improvement of overall mechanism of the corporate governance and performance. Black, Jang, & Kim (2003) who study 515 Korean listed company found that corporate governance (proxy by Korean Corporate Governance Index (KCGI) have significant positive relationship with performance (Tobin Q). They prove that “Shareholder Right” (Sub-index A), “Board in General” (Sub-index B), “Disclosure” (Sub-index E) and “Ownership Parity” (Sub-index P) have strong positive significant relationship with performance (Tobin Q) but “Outside Directors” (Sub-index C) and “Audit Committee” (Sub-index D) have weak positive relationship with Tobin Q Therefore the variables explained in the conceptual model were explained by the following were the proposed hypotheses:

***H1(a) :*** *BOD has a positive relationship with TOBIN Q*
***H1(b) :*** *NOM has a positive relationship with TOBIN Q*
***H1(c) :*** *RMM has a positive relationship with TOBIN Q*
***H1(d) :*** *REM has a positive relationship with TOBIN Q*
***H1(e) :*** *AUD has a positive relationship with TOBIN Q*
***H1(f) :*** *COM has a positive relationship with TOBIN Q*

Malaysian business environment were claimed to have high ownership concentration around 31% of companies shareholding were whole by single largest shareholder and 62% were hold by five largest shareholders (Roszaini & Muhammad, 2006). An empirical studies done by Manawaduge & Rudkin (2009) on the ownership concentration with performance of 45 Sri Lankan listed companies using percentage of 10 largest shareholding and the Herfindahl Index (HERF) as ownership concentration variable. They found that ownership concentration using HERF have no significant effect on performance proxy by ROA, Tobin Q and ROE. However the 10 largest shareholders show significant weak positive relation with ROA only. Based on the relationships among the variables explained in the conceptual model above, the following hypotheses were formulated.

**H2(a) :** The higher the BOD, the higher the TOBIN Q, if there is a high percentage of Shares owned by 10 largest shareholders(POC) in the company

**H2(b) :** The higher the NOM, the higher the TOBIN Q, if there is a high percentage of Shares owned by 10 largest shareholders(POC) in the company

**H2(c)** : The higher the REM, the higher the TOBIN Q, if there is a high percentage of Shares owned by 10 largest shareholders(POC) in the company

**H2(d) :** The higher the RMM, the higher the TOBIN Q, if there is a high percentage of Shares owned by 10 largest shareholders(POC) in the company

**H2(e) :** The higher the AUD, the higher the TOBIN Q, if there is a high proportion of share held by the executives' directors (Management Ownership) in the company

**H2f** The higher the COM, the higher the TOBIN Q if there is a high percentage of Shares owned by 10 largest shareholders (POC) in the company

## 4. Methodology

The population of this study made up of all the companies listed on the main board of Bursa Malaysia from the year ended 2009 until 2013.The sample of companies were chose based on companies that manage to maintain their position in the top 500 public listed companies by market capitalization in Bursa Malaysia and those companies whose financial information available in the Data for the six consecutive year from 2009 until 2013 consistent with Wahab, How, & Verhoeven (2007) and Che Haat et al.(2008) studies. Besides that, mining, hotel and finance industry also will be excluded from this study due to different regulatory framework and governance environment. BAFIA companies or financial companies were legislated with BAFIA Act 1989, Central Bank of Malaysia Act 1958 (Revised 1994), whereas non financial companies legislated with Companies Act 1965. All the measurements of variables are summarizing in Table 2 below.

**Table 2 :** ***Measurement of variables***

| Variables | Measurement | Symbols |
|---|---|---|
| **Dependent Variables** | Tobin Q : Market Value capitalization plus Total Debt over Total Assets | TOBIN Q |
| **Independent Variables (Board Governance Mechanism Index (BGMI)** | Board Matters | BOD |
| | Nomination Matters | NOM |
| | Risk Management Matters | RMM |
| | Remuneration Matter | REM |
| | Audit Matter | AUM |
| | Communication Matters | COM |
| **Moderator Variable** | Concentration Ownership : Percentage of Ownership Concentration | POC |
| **Control Variables** | Leverage : Total Debt over Total Asset | DR |
| | Size of the firm : Log Market Capitalization | LOGSIZE |
| | Type of Industries<br>(Dummy1:Manufacturing Industries<br>(Consumer Product, Industrial Product And Trading And Services Companies)<br>Dummy 2: Heavy Industries (Property, Plantation And Construction Companies)<br>(Dummy 3: Others Industries<br>(Technology, Infrastructure) | TYPE<br>TYDM1<br><br>TYDM2<br>TYDM3 |
| | Liquidity: Log Liquidity | LGLIQ |

**4.1 Independents Variables: The Development of Board Governance Mechanism Index (BGMI)**

BGMI were adopted and adapted from Corporate Governance Index developed by Malaysian Corporate Governance 2008 and 2012 (part 1 and part 2) and some of the items also selected under MSWG governance scorecard and MSWG corporate governance index developed in 2009. (Refer to Table 3.3). Several sessions of discussion with 3 professionals who have more than 5 years accounting & auditing experience including 2 accounting lecturers were done to improvise and modification the original Corporate Governance Index to suit the objective of the study which include the board matters, nomination matters, remuneration matters, audit matters and communication matter.

The Board Governance Mechanism Index (BGMI) was the indexes that will be used as the tool to measure the board of directors governance system in Malaysian Listed Companies .This study will employed the corporate governance index adopted from MSWG governance scorecard and MSWG corporate governance index developed in 2009 as well as based on part 1 and part 2 of Malaysian Code of Corporate Governance which include the board matters (15 items), nomination matters (11 items), Risk Management matters (8) remuneration matters (10 items), audit matters (14 items) and communication (8 items).(Refer to Table 3)

**Table 3** *Sample of MSWG Governance Scorecard and MSWG Corporate Governance Index*

| Indexes | Total Items | Description |
|---|---|---|
| Board Matters Index | 15 | Measures independence of board, disclosure of directors' detail such as previous employments, and educational qualification, CEO-chairman separation, frequency of board meeting, and attendance of board meeting |
| Nomination Matter Index | 11 | Measure existence, independence and activities of nomination committee. |
| Risk Management Matters | 8 | Measure existence, independence and activities of risk management committee |
| Remuneration Matter Index | 10 | Measures independence of remuneration committee, frequency and attendance of remuneration committee meeting, and disclosure of director remuneration. |
| Audit Matter Index | 14 | Measures independence of audit committee, frequency of audit committee meetings, attendance at audit committee meetings, and task of audit committee. |
| Communication Mater Index | 8 | Measures effectiveness of a company communication with shareholders, such as board committee and external auditor present in annual general meeting of shareholders and availability of company's annual report in web site. |

**Limitation**

This study is at initial stage and many of the developments are still in the early process. The corporate governance index was developed to analyze the overall governance matters in the companies and examining the effect of the concentration ownership as moderator that will strengthen the relationship between corporate governance index and performance. The result obtained will be useful to regulator, investors, corporations and other who contend that good corporate governance is important to increase the companies performance.

**Conclusion**

The main objective of this study is to analyze the effect of ownership structure on the relationship between the board of director's governance mechanism and performance of Malaysian companies. This proposed study will cover the wide spectrum of corporate governance mechanism internally and externally in identifying the strength of each corporate governance dimension with performance and concentration ownership as moderator would be one of the factors that will improve the corporate governance and performance consistently throughout the years.

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