

Board of Directors and Ownership Structure: A Study on Small and Medium Enterprises (SMEs) in Malaysia

(Ahli Lembaga Pengarah dan Struktur Pemilikan: Kajian Perusahaan Kecil dan Sederhana (PKS) di Malaysia)

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ABSTRACT

Small- and medium-sized enterprises (SMEs) do not gain sufficient economic returns despite their significant economic contributions. A possible cause of poor SME performance is weak corporate governance. However, the corporate governance of SMEs is rarely investigated. Ownership structure provides SMEs with a monitoring mechanism that enhances performance. This study examines the relationships between board characteristics (including size, composition boards, CEO duality, expertise, and ethnicity) and SME performance in Malaysia. This study also explores how such relationships can be moderated by monitoring ownership structure. Survey results on SMEs in Klang Valley and Selangor areas show that non-executive boards and CEO duality are significantly and positively related to firm performance. In comparison, management ownership is significantly and negatively related to performance. Board size, expertise, ethnicity, and family ownership are not significantly related to SME performance. Findings indicate that good corporate governance improves decision making and firm performance. Furthermore, agency theory can explain conflict of interest in SMEs and the importance of corporate governance in enhancing their performance.

Keywords: SMEs; corporate governance; CEO duality; ethnicity; managerial ownership; family ownership

ABSTRAK

Meskipun perusahaan kecil dan sederhana (PKS) menyumbang secara signifikan kepada ekonomi negara, sektor ini tidak memperoleh pulangan ekonomi yang lumayan. Prestasi yang lemah ini berlaku mungkin akibat tadbir urus korporat yang tidak kukuh. Namun, bilangan kajian tadbir urus korporat PKS sangat sedikit. Kajian lepas menunjukkan struktur pemilikan merupakan mekanisma pemantauan yang meningkatkan prestasi PKS. Kajian ini meneliti hubungan ciri lembaga pengarah (termasuk saiz, komposisi ahli, pengarah urusan dualiti, kepakaran dan jenis etnik) dengan prestasi PKS di Malaysia. Kajian ini turut meneroka peranan struktur pemilikan menguatkan hubungan tersebut. Hasil tinjauan PKS di sekitar Lembah Klang dan Selangor menunjukkan ahli lembaga pengarah bukan eksekutif dan pengarah urusan dualiti masing-masing mempengaruhi prestasi syarikat secara positif dan signifikan. Pemilikan pengurusan pula mempengaruhi prestasi syarikat secara negatif dan signifikan. Hubungan yang signifikan tidak wujud antara saiz lembaga pengarah, kepakaran, jenis etnik dan pemilikan keluarga dengan prestasi PKS. Secara keseluruhan, hasil kajian menunjukkan bahawa tadbir urus korporat yang baik meningkatkan proses pembuatan keputusan dan prestasi syarikat. Kajian ini membuktikan bahawa teori agensi adalah relevan untuk menerangkan konflik kepentingan di kalangan PKS dan tadbir urus adalah perlu untuk meningkatkan prestasi.

Kata kunci: PKS; tadbir urus korporat; pengarah urusan dualiti; jenis etnik; pemilikan pengurusan; pemilikan keluarga

INTRODUCTION

The poor governance of SMEs may create opportunities for expropriation of assets, which may result in ineffective management (Walker & Fox 2002). Ineffective management may lead to various consequences, such as low performance, decreased firm value, and increased financing risk (Afrifa & Tauringana 2015). This

phenomenon is evident from the low average productivity of SMEs in Malaysia (The SME Annual Report 2015/2016). The SME Annual Report (2015/2016) indicates that SMEs contribute only 36.3% to gross domestic product (GDP); this level is lower than that in other countries, such as Japan, South Korea, and Germany, where the contribution of SMEs to the GDP exceeds 50% (Thomas 2014).

The success or failure of a company, regardless of whether it is a listed company or a SME, is determined by the corporate governance practices (Chung 2011). Empirical evidence shows that good corporate governance results in a positive effect on performance among listed companies (Bhagat & Bolton 2008; Ibrahim 2011; OECD 2005). Good governance improves the management effectiveness and strengthens the firm performance thereby generating economic resources in terms of job opportunities, dividends, and taxes; these factors benefit society (Tornyeva & Wereko 2012). A poor corporate governance on the other hand, may weaken the firm performance which may lead to the macro-economic crises and consequently affects the economic growth of the country negatively. The Asian economic crisis is an example of the drop in share prices, which may have been triggered by the lack of good governance (Mitton 2002).

The poor performance of SMEs may possibly be associated to the low level of corporate governance practices resulting from the non-mandatory requirements on good governance practices among SMEs (Heuvel 2006). Heuvel (2006) argues that corporate governance may be able to improve the performance of SMEs in a similar manner to the positive outcome on the performance of listed companies. It is expected that the SME performance may be improved with the implementation of good corporate governance practices. As Heuvel (2006) clearly argues, corporate governance has an important role in the enhancement of the performance of SMEs which would contribute significantly to the increase in the Malaysian economy. However, there is currently a lack of evidence that support the positive effects of governance monitoring on SME performance (Heuvel 2006). The positive significant effect of good governance on firm performance was concluded mainly from studies on publicly listed companies (Bhagat & Bolton 2008; Gillan 2006; Jackling & Johl 2009).

This study attempts to close the gap by investigating the relationship between corporate governance and SME performance. The results are expected to provide basis for the development of policies that require corporate governance practices in SMEs to enhance and sustain their performance, significance, and relevance to the Malaysian economy (Tornyeva & Wereko 2012). In this study, the discussions are benchmarked against the governance practices of listed companies.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

SMEs are companies that are not listed in any stock exchange because of their limited number of shareholdings or restrictions on the transfer of resources (OECD 2005). SMEs comprise sole proprietorships, family businesses, partnerships, and companies. The management decisions and business direction of SMEs are made by majority equity holders. In Malaysia, the Board of National Development of

Small and Medium Enterprises (i.e., *Majlis Pembangunan Perniagaan Kecil dan Sederhana Kebangsaan* or MPPK) has provided a standardized definition of SMEs that took effect on 1 January 2014. According to the MPPK guideline, SMEs in Malaysia are can be categorized into micro, small, or medium enterprise depending on the amount of sales or number of full-time employees. Most SMEs in Malaysia belong to the agro-base, manufacturing, agriculture, or service industries.

SMEs play an important role in a country's economic development. SMEs in Malaysia account for 97.3% of the total number of business organizations (The Economic Census Report 2011). SMEs dominate the economy through their large contributions to the GDP and job opportunities (Akugri, Bagah & Wulifan 2015; Omar, Arokiasamy & Ismail 2009; UNDP 2007; Voordeckers 2007). In addition, SMEs provide job opportunities to more than 50% of the total workforce. Thus, SMEs comprise a large economic sector that significantly contributes to the increase in national income (International Finance Corporation 2006). Thus, the performances of both listed companies and SMEs are vital to a country's economic development.

The average productivity of SMEs in Malaysia is only one-third of the productivity of large organizations. This level is lower than that that in other countries. For example, the productivity of SMEs in Singapore and the United States is four and seven times higher than that in Malaysia (Master Plan of SMEs 2012-2020). SME performance reflects the economic position and prosperity of a country (Tornyeva & Wereko 2012). The ability of SMEs to contribute to the economy becomes questionable when they perform poorly. SMEs must improve their performance to boost their economic contribution.

CHARACTERISTICS OF CORPORATE GOVERNANCE

The Malaysian Code on Corporate Governance (Malaysian Institute of Corporate Governance, 2012) and the Corporate Governance Guide of Bursa Malaysia Berhad (Bursa Malaysia Bhd. 2013) have outlined specific characteristics that are considered the best corporate governance practices for firms. These characteristics cover the aspects of management, board of directors, audit committees, and other relevant stakeholders, such as auditors which are important in enhancing firm performance.

The Code did not specify the appropriate number of directors. Gregory (2007) suggests the ideal number of board members at between 5 and 10. However, the decision on the optimal size of the board is unique to each company and is driven by the notion that the board should neither be excessively large nor small which would discourage efficient and effective decision-making (Gregory 2007). A considerably small board size reduces the ability of the board for management control, whereas a significantly large board size hampers communication and work alignment (Eisenberg, Sundgren & Wells 1998). An optimal board size positively influences firm performance by promoting the participation of board

members in performing their functions (Yermack 1996). Beyond optimal size, increased board size improves a firm's financial burden to cover the compensation costs and incentives of board members (Haniffa & Hudaib 2006). In Malaysia, a small board size enhances firm performance because of the low costs of compensation and incentives (Ibrahim 2011).

However, a number of scholars argued that board size is positively related to firm performance (Daily & Dalton 1993; Jackling & Juhl 2009; Pearce & Zahra 1992). A large board size provides improved intellectual knowledge, which improves the quality of strategic decisions that positively drive firm performance (Daily & Dalton 1993). A large board size also reduces the controlling power of the CEO over the management (Forbes & Milliken 1999). When the board is large, the CEO becomes accountable to additional queries. However, once the board size becomes excessively large, its effect on firm performance becomes decreases because of additional costs (Bennedson, Kongsted & Nielsen 2008).

The effect of board size on SMEs may differ from that in listed companies (Eisenberg et al. 1998). Increased board size of SMEs is expected to improve firm performance (Abor & Adjasi 2007; Hamad & Karoui 2011; Swamy 2011). The board of directors of SMEs play a minor role in monitoring, supervising, and giving incentives because of the owner–manager relationship (Bennedson et al. 2008). The agency problem that arises from the conflict of interest between managers and owners is minimized when managers are owners. Owners are motivated to manage the firm to their best interest. Thus, boards of directors of SMEs have an insignificant monitoring role. This finding suggests that SMEs requires a smaller number of board members than listed companies. This study attempts to determine the appropriate board size that can improve SME performance. Thus, the following hypothesis is developed:

H_{1a} The size of board of directors has a positive and significant relationship with SME performance.

Appointing an external director or a non-executive director is an issue in SMEs. The number of external directors in the board of SMEs is considerably small (Brunninge, Nordqvist & Wiklund 2007; Coulson-Thomas 2007). The majority of SMEs do not formally appoint board members (Uhlener, Wright & Huse 2007). Most owner–managers of SMEs do not believe in the necessity of appointing a board of directors and they do not recognize their contributions (Neville 2011). Thus, SMEs do not benefit from the contributions of external directors (Bettinelli 2011).

Agency theory suggests that a high ratio of external directors can help in effectively monitoring the conflict of interest between management and shareholders (Fama & Jensen 1983). Independent external directors reduce the opportunities of internal directors to deny shareholder interest (Fama & Jensen 1983; Gabrielsson & Huse 2005). A high ratio of external directors positively affects firm

performance (Fama & Jensen 1983). Most SMEs have limited internal resources, such as managerial skills and expertise (Daily & Dalton 1992). Thus, experienced and independent external directors must be appointed to complement shortage in knowledge, experience, and skills in managing a company (Gabrielsson & Huse 2005). External directors can share their financial knowledge, which aids the management in obtaining financing and enhancing firm performance (Abor & Adjasi 2007). Therefore, the following hypothesis is developed:

H_{1b} External directors have a positive and significant relationship with SME performance.

A number of companies practice CEO duality, wherein the CEO also acts as the chairman of the board of directors. CEO duality may negatively affect firm performance (Fama & Jensen 1983). When separate individuals manage and control policies and board decisions, the effectiveness of monitoring of top management improves (Fama & Jensen, 1983). The board can effectively perform its monitoring role when the positions between the CEO and the chairman are separated. Separating the two positions also reduces the opportunities for the CEO and other internal board members to take advantage of situations that do not increase firm value (Braun & Sharma 2011). However, other scholars argue that CEO duality enhances the performance of companies, particularly SMEs (Donaldson & Davis 1991). CEO duality is a common practice in SMEs, especially when the board size is small and external directors are few (Corbetta & Montemerlo 1999; Huse 2000; Lappalainen & Niskanen 2012). Gill, Mand and Mathur (2012) and Westhead (1997) argued that CEO duality in SMEs promotes the monitoring role that ensures that the welfare of stakeholders is prioritized. CEO duality is ideal for making good decisions and forming a well-designed, strong, and transparent leadership structure. SMEs with CEO duality gain high profits because of the aligned leadership structure and the low cost of conflict between the CEO and the board of directors (Gill, Mand & Mathur 2012). An individual who serves as CEO and chairman can make good decisions (Donaldson & Davis 1991; Gill, Mand & Mathur 2012). The positive effect of CEO duality depends on the size of the firm (Huse 2000). CEO duality offers additional benefits in SMEs, where clear and focused decisions are important for the management. CEO duality is expected to improve SME performance (Abor & Biekpe 2007; Huse 2000). SMEs with CEO duality perform better than those without CEO duality (Gabrielsson 2007). The positive effect of CEO duality on firm transparency is particularly significant in advanced SMEs. By contrast, large firms may perform well when two separate individuals perform the roles of CEO and chairman (Fama & Jensen 1983; Gill 2011). Therefore, the following hypothesis is developed:

H_{1c} CEO duality has a positive and significant relationship with SME performance.

The financial literacy of board of directors with regard to the nature of business, development level, and firm operation is important in enhancing firm performance (Coulson-Thomas 2007). The financial literacy required for managing a listed company may differ from that of a newly formed SME. An effective monitoring of firm operation can be guaranteed by a board of directors equipped with knowledge and skills in finance and accounting (Fauziah & Yusoff 2012). The literacy of a board encompasses different aspects, including finance, corporate planning, business forecast, law, risk management, human resources, and international business; these aspects are important for firm performance.

In Malaysia, Zulridah and Iskandar (2012) found that financially literate boards of directors were capable of securing financially distressed companies. Companies managed by financially literate board of directors sustained their businesses. However, only a few SME directors in Malaysia are financially literate (Radam, Abu & Abdullah 2008). Thus, a growing demand for directors with financial literacy exists in accounting and finance.

The literacy of board of directors can increase their efficiency to perform the directorship role of improving firm performance (Abor & Biekpe 2007; Babic, Nikolic & Eric 2011; Lybaert 1998). Directors who are knowledgeable and skilled in accounting and finance can effectively perform various duties, including internal control and accounting procedure review, reporting, problems solving, and decision making (Jeanjean & Stolowy 2009). Board members with accounting and finance backgrounds can improve the credibility and image of the company (Haniffa & Cooke 2006).

Financially literate board of directors can properly monitor firm performance (Gabrielson & Winlund 2000; Lybaert 1998). They can comment and guide the management on various managerial issues, including capital sourcing and overcoming financial problems. Financially literate directors can enhance the effectiveness of the controlling and monitoring roles of the board. SMEs managed by owners who lack knowledge and skills on accounting or finance may suffer from high agency costs (Ang, Cole & Lin 2000). Thus, the board's literacy in accounting and finance enhances the capability of managers to handle company activities, particularly those relating to financial matters, and consequently improves performance.

H_{1d} The financial literacy of the board of directors has a positive significant relationship with SME performance.

Diversity in the ethnicity of the board is a common phenomenon in the multiracial society of Malaysia. The business performance of firms is influenced by the diversity of race, culture, and language, which reflect the multicultural and multiracial society of Malaysia (Haniffa & Cooke 2005). Different races, such as Malay, Chinese, and Indian, retain their own identities. Cultural differences affect the corporate governance of companies

(Haniffa & Cooke 2005). Directors from diverse ethnic backgrounds possess unique cultural values and religious beliefs (Salleh, Jenny & Manson 2006). These differences affect the board's effectiveness in performing, controlling, and monitoring company activities.

Two main ethnic groups, namely, Malays and Chinese, significantly contribute to the socioeconomic development of Malaysia (Haniffa & Cooke 2002). Malays are the majority race in this country, but the Chinese are the main economic contributors (Mamman 2002). Ethnicity differences at the top management significantly affect the corporate governance practices in Malaysian companies (Marimuthu & Kolandaisamy 2009; Salleh et al. 2006; Yatim, Kent & Clarkson 2006). The ethnicity of the board considerably affects the performance of listed companies (Marimuthu & Kolandaisamy 2009). Companies owned by Malays, which are known as Bumiputera companies, practice internal governance (i.e., quality audit); by contrast, those owned by Chinese and other races, which are known as non-Bumiputera companies (Yatim et al. 2006).

Ethnic diversity among board members improved the performance of listed companies in Malaysia (Marimuthu & Kolandaisamy 2009; Marimuthu 2008). Firm performance, which is typically measured by the return on assets or return on equity, differs across firms with different ethnic backgrounds. In conclusion, the ethnicity of the board of directors influences a firm's financial performance, information disclosure, and reporting quality (Haniffa & Cooke 2005; Marimuthu 2008; Marimuthu & Kolandaisamy 2009; Salleh et al. 2006). These studies obtained mixed results. Several studies highlighted the positive effects of ethnical diversity (Marimuthu 2008; Marimuthu & Kolandaisamy 2009; Haniffa & Cooke 2005), whereas others declared that the ethnicity of the board of directors had no significant effects on firm performance (Salleh et al. 2006).

Existing evidence is obtained from studies on listed companies. Corporate governance is expected to positively affect SME performance. Unlike listed companies, SME performance is difficult to measure because of lack of information (Uhlener et al. 2007). Therefore, the following hypothesis is developed:

H_{1e} The ethnicity of the board of directors is significantly related to SME performance.

OWNERSHIP STRUCTURE OF SMES

SMEs typically have concentrated ownership structures that are dominated by family members (Stijn Claessens, Djankov, Fan & Lang 2002). Concentrated ownership structure is a common feature that accounts for 60% of the companies in Malaysia (Rachagan & Satkunasingam 2009). Concentrated ownership exists when a large amount of shares (i.e., at least 5% of firm equity ownership) is held by an individual investor or large-block shareholders.

A concentrated ownership structure may result in agency problems between majority and minority

shareholders. An agency problem occurs when the minority shareholders are denied of their rights by the majority shareholders or by the owner-manager (Ding, Zhang & Zhang 2007). Majority shareholders or shareholders who are managers are not motivated to maximize the wealth of minority shareholders or shareholders who are not managers; rather, they intend to maximize returns for their benefit. This scenario is promoted by weak corporate governance (Rachagan & Satkunasingam 2009). An agency problem occurs because firm owners who own a majority share of the equity leave only a small equity portion for the minority shareholders. Owners who are managers have different priorities and objectives from owners who are not managers, resulting in a unique conflict of interest between majority and minority shareholders (Neville 2011; Walsh & Seward 1990). When managing the company, an owner–manager tends to be opportunistic and prioritizes his or her self-interest, thereby negatively affecting firm performance (Demsetz & Villalonga 2001; Miller & Breton-Miller 2006). Examples of such acts include decisions not to provide an appropriate amount of dividend to minority shareholders (Chu 2009).

The managerial ownership of concentrated ownership companies is significantly related to company performance (Arosa, Iturralde & Maseda 2010; Demsetz & Villalonga 2001; Miller & Breton-Miller 2006; Shleifer & Vishny 1997; Wellalage & Locke 2011). Managers who have high equity ownership may use their positions to deny the right of shareholders who do not manage the distribution of company profit. This attitude negatively affects firm performance. A high level of managerial ownership results in ineffective investment decisions, which are indirectly detrimental to company performance (Cronqvist & Nilsson 2003).

SMEs generally have a concentrated equity ownership structure and limited liability. The effect of equity ownership structure on the management of listed companies differs from that on SMEs (Mueller & Spitz-Oener 2006). The percentage of ownership by the manager in SMEs is usually large (Mueller & Spitz-Oener 2006). Such highly concentrated equity ownership of SMEs by the management is negatively related to company performance. This negative relationship is attributed to the increased cost of agency-principal as a result of denying minority shareholders of their rights.

H_{2a} Managerial ownership has a significant negative relationship with SME performance.

Family ownership is the main form of ownership structure of SMEs in Asia (Ibrahim & Samad 2010). This case also applies to Malaysia, where family members are majority owners. The family ownership structure functions as a corporate governance mechanism in SMEs (Claessens & Fan 2003). Agency theory posits that a family-owned company managed by family members mitigates the

interest gap between the owner and the manager. No agency cost will be incurred in the absence of such a gap. However, other scholars argued that agency costs can still be incurred in family-owned companies (Ben-Amar & Andre 2006; Schulze, Lubatkin & Dino 2003). In family-owned companies, family members involved in firm management will directly or indirectly influence the decision making of the firm (Chen & Yu 2011). Managers of family-owned firms tend to take actions beyond controlling the operation to fulfill the interest of their family; by contrast, managers of non-family-owned firms always strive to ensure that decisions are made for the interest of the stakeholders (Arosa et al. 2010; Schulze et al. 2003). Owner-managers of family-owned firms tend to sacrifice the interest of minority shareholders who are non-family members and they tend to favor family members for high management-level positions or for extraordinary dividends (Shleifer & Vishny 1997; Demsetz 1983; Fama & Jensen 1983). The payment of extraordinary dividends or compensation incurs additional costs and reduces firm income (Gomez-Mejia, Nunez-Nickel & Gutierrez 2001).

H_{2b} Family ownership has a significant and negative relationship with SME performance.

METHOD

In view of the unavailability of audited financial statements, this study used a questionnaire survey to collect the necessary information from selected SMEs (Uhlener et al. 2007; Hashim 2011; Fiegenger 2000; Hamad & Karoui 2011).

QUESTIONNAIRE

The questionnaire was divided into three parts. The first part contained questions regarding the firm's background and financial information. The second part inquired about the demography and characteristics of the board of directors. The third part included questions about firm ownership structure (see Appendix 1).

OPERATIONALIZATION OF VARIABLES

Table 1 summarizes the operationalization of variables. Firm performance was measured from the return on assets, which is calculated by dividing the net income by the average total assets. Firm size was measured by the number of board members. The ethnicity of the board of directors was determined based on the percentage of Bumiputera directors on the board. The three dummy variables were external directors, CEO duality, and financial literacy of board of directors. The measurements of the control variables are also included in Table 1.

TABLE 1. Operationalization of variables

Variables	Measurement
Dependent Variables	
<i>Firm performance</i>	Return on assets = Net income / Average total assets (Arosa et al. 2010; Demsetz & Villalonga 2001)
Independent variables	
<i>Size of board of directors</i>	Number of board members (Abor & Biekpe 2007; Hamad & Karoui 2011)
<i>External board of directors</i>	External directors = 1 No external directors = 0 (Bammens & Voordeckers, 008; Brunninge et al. 2007)
<i>CEO duality</i>	CEO duality = 1 No CEO duality = 0 (Abor & Biekpe 2007; Bhagat & Bolton 2008; Hamad & Karoui 2011)
<i>Financial literacy of board of directors</i>	Financial literacy = 1 No financial literacy = 0 (Jusoh 2008; Razman & Iskandar 2004)
<i>Ethnicity of board of directors</i>	% of Bumiputera directors on the board (Haniffa & Cooke 2002; Salleh et al. 2006)
<i>Managerial ownership</i>	Managerial ownership > 50% = 1 Managerial ownership < 50% = 0 (Abor & Biekpe 2007; Mueller & Spitz-Oener 2006)
<i>Family ownership</i>	Family ownership > 50% = 1 Family ownership < 50% = 0 (Anderson et al. 2003; Wu et al. 2007)
Control Variables	
<i>Firm size</i>	Total annual sales (Arosa et al. 2010; Morck et al. 1988)
<i>Years of formation</i>	No. of years in business since establishment (Arosa et al. 2010; Abor & Biekpe 2007)
<i>Debt ratio</i>	Ratio of debt to equity (Abor & Biekpe 2007)

RESULTS

DESCRIPTIVE STATISTICS

SAMPLE

Six hundred and nineteen SMES in the area of Kuala Lumpur and Selangor were initially short listed for the study. However, 243 SMES were discovered to have either closed down or move to new locations. The final sample consists of 376 SMES in Kuala Lumpur and Selangor, wherein most SMES are located. Only 83 questionnaires were returned, of which 74 questionnaires (i.e., 20%) were usable. The data was collected in the year 2014. Table 2 summarizes the samples.

TABLE 2. Sample

Description	Total	%
Total sample	376	100
Completed questionnaires returned	83	22
Questionnaires with incomplete information	(9)	(2)
Usable questionnaires	74	20

The descriptive statistics of the variables are summarized in Table 3, wherein 56.8% of participating SMES have two-member boards of directors. Most SMES (86.5%) do not have external directors. CEO duality is practiced by 77% of the SMES. The practice of CEO duality coupled with the low percentage of external directors indicates the lack of independence among the top-management group members. Board members who are not financially literate comprised 62.2%. The lack of independence and financial literacy indicates the low level of competency of the board of directors of SMES. Approximately 69% of the SMES have at least 50% Bumiputera board members; 90.5% of the SMES maintain 50% managerial ownership structure; and 55.4% of SMES are managed by family members.

TABLE 3. Descriptive statistics

Variables	Measurement of Variables	No. of Companies (N = 74)	%
Board size	2 board members	42	56.8
	3 board members	21	28.4
	4 board members	3	4.1
	5 board members	8	10.8
Existence of external directors	No external directors	64	86.5
Existence of external directors	With external directors	10	13.5
CEO duality	Non-CEO duality	17	23.0
CEO duality	CEO duality	57	77.0
Financial literacy of board of directors	Without financial literacy	46	62.2
Financial literacy of board of directors	With financial literacy	28	37.8
Ethnicity of board of directors	< 50% Bumiputera board members	23	31.0
Ethnicity of board of directors	≥ 50% Bumiputera board members	51	69.0
Managerial ownership	< 50% Managerial ownership	7	9.5
Managerial ownership	≥ 50% Managerial ownership	67	90.5
Family ownership	< 50% Family ownership + non-family managers	33	44.6
Family ownership	≥ 50% Family ownership + family managers	41	55.4

DATA TEST

The results of the data test using skewness and kurtosis statistics methods show that data normality was not a problem in this study (Tabachnick & Fidell 2013). Table 5 shows that the correlation coefficients among variables range from $-.321$ to $.376$. Thus, multicollinearity is not an issue because the correlation coefficients do not exceed $.70$ (Hair, Black, Babin, Anderson & Tatham 2009). Aside from normality test, homoscedasticity must also be checked to ensure the absence of heteroscedasticity. Table 4 shows

that the Obs*R-squared value is 6.04, which is smaller than the critical chi-square value of 18.31 at a significance level of 0.05. Thus, the hypothesis of homoscedasticity is rejected in favor of heteroscedasticity.

TABLE 4. White heteroskedasticity

F-statistic	0.559996	Probability	0.84
Obs*R-squared	6.040774	Probability	0.8118
		Chi-Square	

TABLE 5. Correlation between variables

Variables	Perform	Size	External	Duality	Literacy	Ethnicity	ManOwn	FamOwn	CompSize	ComAge	Debt ratio
Perform	1										
Size	-.09	1									
External	.167	.208	1								
Duality	.147	-.109	-.066	1							
Literacy	-.088	.307	.018	.029	1						
Ethnicity	.177	-.119	-.145	-.149	.056	1					
ManOwn	-.321	-.198	-.277	.263	-.129	-.093	1				
FamOwn	-.024	.105	.196	.092	.195	-.099	-.104	1			
CompSize	-.019	.376	.156	.038	.184	.025	.03	.269	1		
ComAge	-.299	.071	.218	-.04	.002	-.201	-.014	.109	.386	1	
Debt ratio	-.222	.059	.263	.101	.132	-.048	.014	.059	.135	.106	1

Notes: Perform - Firm performance
 Size - Size of board of directors
 External - External board of directors
 Duality - CEO duality
 Literacy - Financial literacy of board of directors

Ethnicity - Ethnicity of board of directors
 ManOwn - Managerial ownership
 FamOwn - Family ownership
 CompSize - Firm size
 ComAge - Years of formation

HYPOTHESIS TESTING

This study used OLS regression for data analysis (Gujarati 2004). As shown in Table 6, the R^2 value is .386, which indicates that 38.6% of changes in the dependent variables can be explained by the independent variables. The adjusted R^2 value is 28.9%, which is consistent with other studies on SMEs (Abor & Biekpe 2007; Hamad & Karoui 2011).

Table 6 shows that no significant relationship exists between board size and SME performance. The result suggests that the SME performance does not depend on board size. The insignificant results may be due to the small SME board size. Table 3 shows that 85.2% of the selected SMEs have three or less board members and 56.8% have only two board members.

TABLE 6. Results of OLS regression analysis

Variables	Coefficient	Std Error	Sig
Size of board of directors	-.013	.051	.803
External directors	.307	.136	.028
CEO duality	.267	.107	.016
Literacy of board members	-.103	.093	.275
Ethnicity of board of directors	.126	.100	.212
Managerial ownership	-.489	.156	.003
Family ownership	-.068	.089	.452
Control variables			
Company size	.067	.065	.306
Company age	-.016	.000	.008
Debt ratio	-.177	.071	.015
Constant	1.418	.240	.000
R^2	.386		
Adjusted R^2	.289		

Table 6 shows a significant positive relationship between external directors and SME performance at $p = .028$. H_{1b} is supported. The result suggests that external directors enhance SME performance. Although only 13.5% of the samples have external directors (see Table 3), the result clearly supports the notion that a larger number of external directors corresponds with a better firm performance.

CEO duality has a significant and positive relationship with SME performance at $p = .016$. The result supports H_{1c} , which suggests that SMEs with the chairmen also act as CEOs would perform better. Table 3 shows that CEO duality is practiced by about 77% of the selected sample of SMEs. For SMEs, a small top management structure requires a strong and transparent leadership. In addition, the appointment of separate individuals for the CEO and chairman positions would involve higher service costs. High service costs among SMEs would have a negative effect on the firm value. The practice of CEO duality may reduce the cost of conflict of interest as the leadership structure is aligned. Thus, CEO duality

may be an appropriate approach for SMEs to optimize the leadership structure.

Financial literacy of board of directors is expected to improve the SME performance. However, Table 6 indicates a lack of significant relationship between financial literacy of the board and firm performance. Table 3 shows only 37.8% of the participating SMEs require their board members to have financial literacy. Board members of the remaining 62.2% do not have financial literacy. Results indicate that the top management of SMEs has a low level of financial literacy. This finding suggests that financial literacy of the top-management personnel is not a priority among SMEs. The lack of financial literacy among SMEs board members may be due to the non-mandatory regulatory requirement. Board members of SMEs are not required to maintain financial literacy of a certain level either as an entry requirement or a continuous professional development.

Table 6 shows that the ethnicity of board of directors is not significantly related to SME performance at $p < .05$. This finding indicates that H_{1e} is not supported. This finding is based on a sample comprising 51 SMEs (69%) with more than 50% Bumiputera board members and 23 SMEs (31%) with less than 50% Bumiputera board members. Results suggest that the SME performance does not differ according to the ethnicity of board of directors.

Table 6 shows that managerial ownership has a significant and negative relationship with SME performance at $p = .003$. This result suggests that SME performance decreases as the percentage of managerial ownership increases. Thus, H_{2a} is supported. As shown in Table 3, the total equity of about 90.5% of participating SMEs are owned by the management by more than 50%.

The results are consistent with the agency theory which suggests that a high level of managerial ownership will have a negative effect on firm performance. A high managerial ownership structure is expected to create a conflict of interest between majority owners who manage the firm and minority owners who do not manage the firm. The conflict of interest arises when the majority owners act for their self-interests by sacrificing the rights of the minority owners. This opportunistic behavior negatively affects firm performance.

This study found no significant relationship between family ownership and SME performance. Thus, the performances of family-owned and non-family-owned SMEs do not differ significantly. H_{2b} is rejected. The descriptive statistics in Table 3 demonstrate that thirty three SMEs (44.6%) in the sample are non-family-owned with less than 50% of family ownership and are managed by non-family members. Forty-one SMEs (55.4%) are family-owned with more than 50% of family ownership and are managed by family members.

DISCUSSIONS AND CONCLUSIONS

This study verified the importance of certain characteristics of corporate governance, namely, external directors, CEO

duality, and managerial ownership. External directors are positively related to SME performance because they contribute to the effective management of the business operation by sharing their knowledge, experience, and skills, which in turn enhances the firm's performance (Gabrielsson & Huse 2005; Samuel 2014). External directors help owners–managers make independent judgments in controlling the firm operation and protecting the shareholders from any negative impact that arises from the misbehaviors of management. External directors promotes the independence and competency of the board of directors. Consequently, independent boards of directors make good firm decisions and exercise independent monitoring of management. The results of this study are consistent with the agency theory which exerts that independent and competent board decisions enhance the firm performance. The results support the hypothesis that SMEs must increase the number of external directors as board members.

CEO duality may be acceptable for SMEs although it may reduce the firm independence. CEO duality minimizes administration and decision-making costs, where cost reduction is prioritized for the sustainability and future growth of SMEs. This suggestion is consistent with the current practice of CEO duality by about majority of SMEs (Abor & Biekpe 2007; Voordeckers 2007; Heuvel & Gils 2006). SMEs with CEO duality would normally perform well, even though they may be small and have a low external director ratio (Huse 2000).

Theoretically, results of this study imply that managerial ownership does not reduce the conflict of interest between the management and shareholders. High managerial ownership among SMEs may increase the controlling decision power of the managerial owners and decrease the governing influence of other shareholders. Although the agency theory suggests that managerial ownership reduces the conflict of interest between the management and shareholders, such relationship cannot be established in the context of SMEs due to small board size comprising of members are owners. The results are consistent with prior SMEs studies which point out that a high level of managerial ownership corresponds to low firm performance (Cronqvist & Nilsson 2003; Hamad & Karoui 2011; Wellalage & Locke 2011). The conflict of interest may arise when the majority shareholders who are managers do not act for the benefit of the firm but for their self-interests resulting in poor firm performance. Thus, this study enhances the applicability of agency theory in clarifying the concept of conflict of interest within the context of SMEs.

Practically, the results of this study support the importance of corporate governance to the performance of SMEs. Consistent with prior studies on corporate governance practices among SMEs in other countries such as Ghana (Abor & Biekpe 2007; Samuel 2014), Nigeria (Obasan, Shobayo & Amaghionyeodiwe 2016), and Tunisia (Hamad & Karoui 2011), findings of this study suggest the need to develop and enforce corporate

governance framework for SMEs in Malaysia. The lack of governance monitoring in SMEs contributes to poor SME performance. Certain characteristics of the board of directors, particularly those related to board independence, are significantly associated with firm performance. The result suggests that mandatory requirements of good governance must be implemented in SMEs to enhance their performance, which in turn increases their economic contribution. The findings provide bases for considering corporate governance as a regulatory code for SMEs to contribute to their sustainability, significance, and relevance to the Malaysian economy.

This study has several limitations. The results of the survey on SMEs in Kuala Lumpur and Selangor may be generalized to SMEs in other areas. The number of external directors is based on the number of external directors in the board. This measure may be enhanced by differentiating independent external directors from non-independent external directors. The competency of the board of directors may be better measured by recognizing knowledge and experience as separate components of financial literacy.

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APPENDIX 1

COMPANY INFORMATION

Name of the Organization: _____

Contact Person's Name and Telephone Number: _____

Date of completing the questionnaire: _____

A. DEMOGRAPHIC INFORMATION

Please fill in the blanks or check (✓) in the appropriate box.

1. Your business was founded in _____ year
2. Your startup capital:
 - ≤ RM50,000
 - > RM50,000 to ≤ RM100,000
 - > RM100,000 to ≤ RM500,000
 - > RM500,000 to ≤ RM1,000,000
 - > RM1,000,000 (please specify) _____
3. Industry of your main business:
 - Manufacturing (including Agro Based)
 - Manufacturing related services
 - Mining and quarrying
 - Services (including ICT)
 - Primary agriculture
 - Other, please specify _____
4. Is your business part of a business group? If the answer is No, please skip Q 5.
Yes No
5. Please choose one of the following:
 - Subsidiary of a family-based business group
 - Subsidiary of a business group not controlled by families
 - Holding company family based
 - Holding company non-family based
 - Other, please specify _____
6. Estimated current capital (2010):
 - ≤ RM50,000
 - > RM50,000 to ≤ RM100,000
 - > RM100,000 to ≤ RM500,000
 - > RM500,000 to ≤ RM1,000,000
 - > RM1,000,000 (please specify) _____
7. Estimated monthly revenue@ sales (2010):
 - ≤ RM10,000
 - > RM10,000 ≤ 50,000
 - > RM50,000 ≤ RM100,000
 - > RM100,000 ≤ RM500,000
 - > RM500,000 (please specify) _____
8. Estimated monthly profit (2010):
 - ≤ RM5,000
 - > RM5,000 ≤ 10,000
 - > RM10,000 ≤ RM50,000
 - > RM50,000 ≤ RM100,000
 - > RM100,000 (please specify) _____
9. Total assets: 2011 2010 2009 2008 2007
 - ≤ RM50,000
 - > RM50,000 to ≤ RM100,000
 - > RM100,000 to ≤ RM500,000
 - > RM500,000 to ≤ RM1,000,000
 - > RM1,000,000 (please specify) _____

10. Total liability: 2011 2010 2009 2008 2007
- ≤ RM50,000
- > RM50,000 to ≤ RM100,000
- > RM100,000 to ≤ RM500,000
- > RM500,000 to ≤ RM1,000,000
- > RM1,000,000 (please specify) _____
11. Total employees: 2011 2010 2009 2008 2007
- ≤ 20 employees
- > 20 ≤ 50 employees
- > 50 to ≤ 100 employees
- > 100 employees (please specify) _____

B. GOVERNANCE STRUCTURE (Please fill in the blanks)

12. Number of members of board of directors (BOD) _____ members.
13. Length of service of the present Chairman _____ years.
- Classification of board members based on following criteria:
- a. Ethnicity:
- Bumiputera _____ members _____ % shares
- Non-Bumiputera _____ members _____ % shares
- b. Family representation:
- Family board member(s) _____ members _____ % shares
- Non family board member(s) _____ members _____ % shares
- c. Type of directorship:
- Executive director _____ members _____ % shares
- Outside director _____ members _____ % shares
- * An outside director is defined as a non-executive who is not a family member, a non-family manager or an affiliated director such as an attorney or accountant.
- d. Gender:
- Male _____ members
- Female _____ members
- e. Age:
- Less than 30 years _____ members
- 31 – 40 years _____ members
- 41 – 50 years _____ members
- 51 – 60 years _____ members
- More than 60 years (please specify) _____ _____ members
- f. Length of service:
- 0 – 5 years _____ members
- 6 – 10 years _____ members
- 11 – 15 years _____ members
- 16 – 25 years _____ members
- 26 years or more (please specify) _____ _____ members
- g. Directorship other company:
- None company _____ members
- 1 – 2 companies _____ members
- 3 – 4 companies _____ members
- 5 – 6 companies _____ members
- 7 – 8 companies _____ members
15. Does the board member have qualification in finance and accounting?
- Yes No
16. If yes, please choose any of the following:
- i. Members of MIA @ other professional bodies' _____ members
- ii. Formal education in accounting & finance _____ members
- iii. Experience in the financial sector _____ members
- (Please specify average number of year experience _____)
17. Does the CEO of your firm also serve as the board Chairman?
- Yes No

18. The number of BOD meeting last year: _____ times.
19. How often is the appointment of new director?
 Every one year
 Every two years
 Every three years
 Others, please specify _____
20. Someone from a law/accounting/consulting firm provides professional services to your firm?
 Yes No

C. OWNERSHIP STRUCTURE AND CONTROL (Please fill in the blank)

21. The percentage of business ownership of the business based on following criteria:

a. Ethnicity:

Bumiputera _____ % shares
 Non Bumiputera _____ % shares

b. Family representation:

Family member(s) _____ % shares
 Non family member(s) _____ % shares

c. Types of investor:

Owner – manager(s) _____ % shares
 Non owner – managers (Professional managed) _____ % shares
 Government agencies _____ % shares
 Foreigner _____ % shares
 Other institutional or banks _____ % shares
 Others, please specify _____ % shares

THANK YOU FOR PARTICIPATING IN THIS SURVEY

