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# **Corporate Governance and Performance of United Malacca Berhad**

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## **ABSTRACT**

The study aims to measure corporate governance and its impact firm performance and risk of United Malacca Berhad (UMB). The method of the study is regression analysis of United Malacca Berhad by using SPSS System. The study found that UMB has a positive relationship between return on asset and return on equity. However, the ROA and leverage ratio was negative relationship. Meaning that the company has borrowed too much money even though they earns profit. The regression analysis show that 2 out of 13 factors are significantly influence the profitability of UMB.

**Keywords: credit risk, liquidity risk, profitability, and macroeconomics**

## **1. INTRODUCTION**

United Malacca Berhad (UMB), formerly known as The United Malacca Rubber Estates, Berhad. The company was incorporated on 27 April 1910 under the Companies Ordinance 1889 by its founder, the late Tun Tan Cheng Lock. He has been as a Chairman until 1960. Thereafter, the company has been managing by his family members until his son. After Tun Tan Cheng Lock was stop managing the company, the late Tun Tan Siew Sin took over the Chairmanship in 1974 after his retirement from the Cabinet. He held the post of Chairman until 1988. Under the distinguished leadership of Tun Tan Siew Sin, the former Minister of Finance, UMB had accumulated substantial reserves which contributed significantly to the financial strength of the Group today. The late Tun Tan Siew Sin has been awarded the National Integrity Award by The Kuala Lumpur Society for Transparency and Integrity on 28 June 2003.

The late Mr. Choi Siew Hong, the former Deputy Governor of Bank Negara Malaysia, who had been on the Board of Directors since 1976, became the Chairman of the Group following the death of Tun Tan Siew Sin in 1988. The Group has expanded and broadened its earnings base and continues to grow steadily in financial strength under his leadership. The present Chairman is Datin Paduka Tan Siok Choo. A Malaysian, she is aged 63. For information, she joined the Board on 8 December 1988 and was unanimously elected by the Directors as Chairperson in July 2011.

As additional information, UMB have the largest total asset in 2015 compared to five previous years. The total asset of the company was growing up 0.96% from RM 1,120,325 million in 2011. However, the net profit of UMB in 2015 was RM 43,245 million where it has been drop 27.25 % from RM 75,647 million in 2011. Even though the profit of the company decreased, the company was still in a good financial condition because the total asset was more than liability they should bear. UMB are exposed to financial risks arising from their operations and the use of financial instruments. The key financial risks include credit risk, liquidity risk, interest rate risk, foreign currency risk and market price risk.

## **2. LITERATURE REVIEW**

According to Giner (as cited in Ridhima, 2017), profitable companies disseminate information, to stand out from less profitable firms. Contrary to the theoretical perspective empirical studies on risk disclosure have found an insignificant relationship between risk disclosure and firm's profitability as cited in Ridihima (2017). To measure profitability of a firm, return on assets that is the ratio of operating income to total assets is used. However, the findings of ROA in United Malacca Berhad (UMB) is profit net of tax to total assets is used.

Next, the findings of this study shows is contradictory to the findings of previous studies which are Ghazali (as cited in Waemustafa and Sukri, 2013), who found a positive relationship between liquidity and ROA. Bourke (1989). Kosmidou and Pasiouras (as cited in Waemustafa and Sukri, 2013) also found a significant positive relationship between liquidity and ROA. The findings found that the ROA and liquidity of UMB was a negative relationship. The study by Köhler (as cited in Waemustafa and Sukri, 2013) suggested that banks with a larger proportion of liquid assets are more stable enabling them to buffer against shock when needed.

Besides with respect to capital structure of a firm, some risk disclosure studies explained by Deumes and Knechal ( as cited in Ridhima, 2017) have found firm's leverage positively and

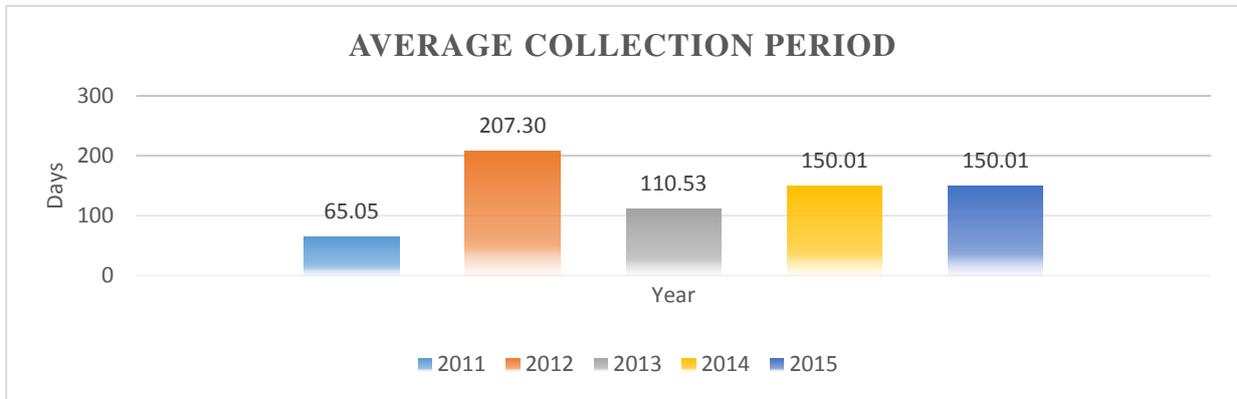
significantly affect the level of risk disclosure whereas, Dobler ( as cited in Ridhima, 2017) has found negative association between firm leverage and risk disclosure. On the other hand some studies as cited in Ridhima, (2017) have found insignificant relationship. Level of firm risk is measured using beta, which is covariance of company's market return relative to market index. Capital structure of the firm is measured using a total debt equity ratio.

Last but not least, the formation of credit risk include, inappropriate credit policies, poor lending practice, limited institutional capacity, volatile interest rate, poor management, inappropriate laws, direct lending, massive licensing of banks, low capital and liquidity risk, laxity in credit assessment, poor loan underwriting, poor lending practice, inadequate supervision by central banks, government interference and inadequate knowledge about borrowers (Kolapo and Kithinji, as cited in Waemustafa and Sukri, 2015). The credit risk of UMB on 2015 was same with last previous year. However, it increased from 2011. In the findings, the relationship between liquidity and credit risk was a positive relationship. It was opposite with Cornet (as cited in Waemustafa and Sukri, 2015) was stated that the higher the liquidity the lower credit risk exposure.

Lastly, as we know, major corporate scams and failures at the international level such as Enron, Worldcom, Adelphia involving accounting irregularities, highlighted the need for good corporate governance regulations to be implemented by the corporations worldwide (Rajab and Schachler, 2009). In addition, the elements of effectiveness which is proposed in conventional corporate governance model are composition, adequate authority, resources and diligence by Ika, S.R., Ghazali, DeZoort, Hermanson, Archambeault, and Reed, (as cited in Waemustafa and Abdullah, 2015). In UMB, the company have diversity in the members of gender which can increase board independence and improve managerial monitoring. It can be one of example good corporate governance. The Agency theory by Jensen and Meckling (as cited in Ridhima, 2017) suggests that board of diverse gender can increase board independence and improve managerial monitoring.

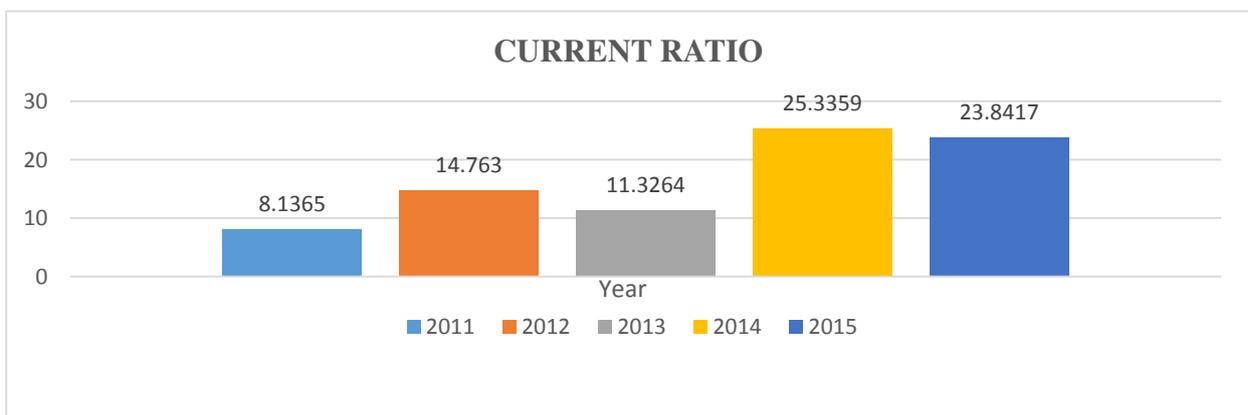
### 3. DESCRIPTIVE ANALYSIS

#### I. CREDIT RISK



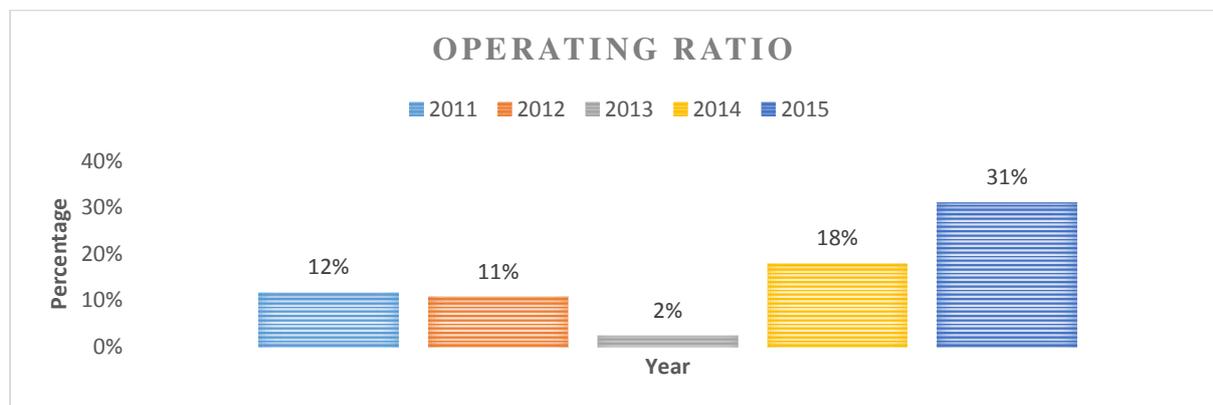
Credit risk refers to the risk that a borrower may not repay a loan and that the lender may lose the principal of the loan or the interest associated with it. In addition, the average collection period is the approximate amount of time that it takes for a business to receive payments owed in terms of accounts receivable. The graph shows it was increasing and decreasing trends year by year. As we can see from the graph above, 207.30 days on 2012 was the highest days to collect account receivable of UMB while on 2011 was the lowest days to collect debt from the account receivable of the company. The longer the days to collect debt from clients, it will be worse for the company's cash flows. On 2011 and 2012, the average collecting period remain unchanged which is 150.01 days respectively. However, the days of collection was increasing from last previous year. This indicate in 2014 and 2015 has longer period to collect the debt compared 2013.

#### II. LIQUIDITY RISK



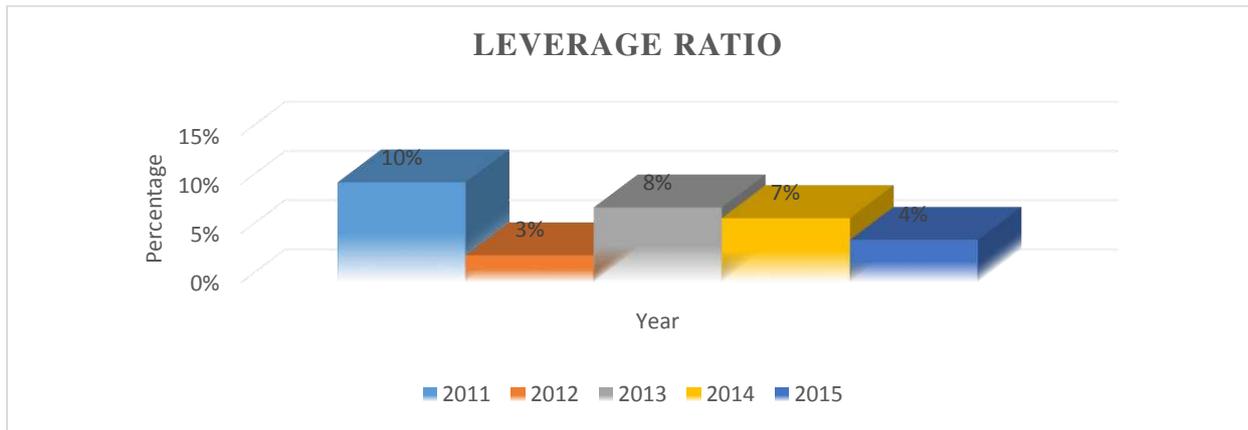
Current ratio, also known as liquidity ratio and working capital ratio, shows the proportion of current assets of a business in a relation to its current liabilities. In addition, a higher liquidity ratio indicates that a company is more liquid and has better coverage of outstanding debts. Based on the graph above, the current ratio of United Malacca Bhd shows a fluctuate trends. It is means the liquidity of the company changed year by year. The highest current ratio of the company in 2014 while 2011 was the lowest one which 25.3359 and 8.1365 respectively. Overall of the current ratio were more than 1 that has provided additional cushion against unforeseeable contingencies that may arise in the short term.

### III. OPERATIONAL RISK



The operating ratio shows the efficiency of a company's management. The smaller the ratio, the greater the organization's ability to generate profit if revenues decrease. As we can see the graph above, in 2013 was the lowest of operating ratio indicates that it has efficient operating environment in which operating expenses are increasingly a smaller percentage of sales whereas in 2015 was 31%. The higher the ratio, the smaller the company's ability to generate profit.

#### IV. LEVERAGE RATIO



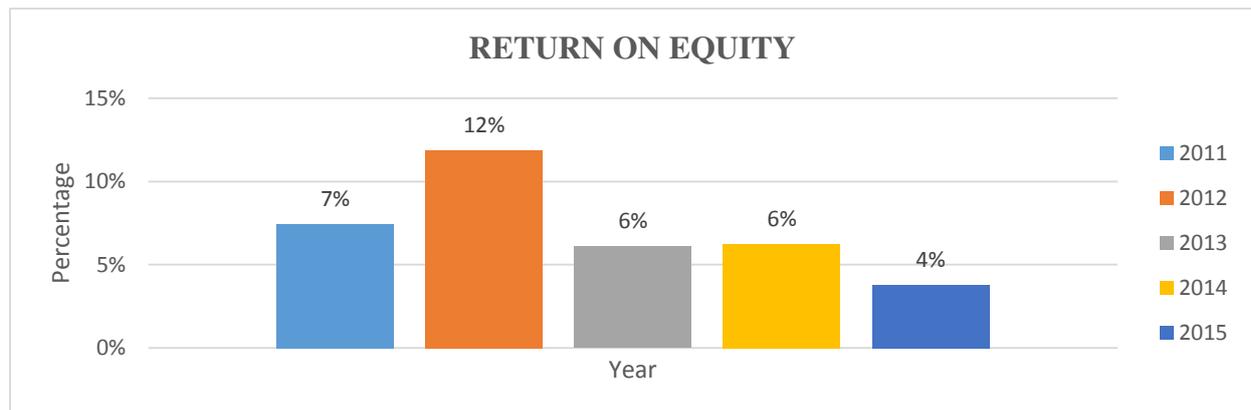
A leverage ratio is means to evaluate a company's debt levels. As indicated above, UMB leverage ratio was growing and declining during 2011 until 2015. In 2015, the ratio was declining 6% from 2011. Therefore, the company was paying off its creditors and thus, owes less money to them. This was indication that the company was becoming stronger. In addition, 2011 has the highest leverage ratio while 2012 was the smallest which 10% and 3% respectively. In 2013 and 2014, the leverage ratio were 8% and 7% means that for every ringgit of UMB assets, UMB had RM 0.08 and RM0.07 of debt. As we can see the graph above, all of debt ratio was below 1.0 indicates that the company has more assets than debt.

#### V.PROFITABILITY RATIO



ROA is net profit to total asset that has been used to measure company performance. The higher of ROA indicates that the company have higher profitability. As we can see from the graph above, the ROA of United Malacca Bhd shows a decreasing and increasing trend over the years. The ROA of UMB was increasing from 2011 until 2012. However it was decreasing on 2013 until 2015. The highest of ROA is on 2012 indicates that the company has higher profitability

during that year while the lowest of ROA is on 2015 that show the profit was decreasing at the moment. It was 12% and 4% respectively. The ROA on 2013 and 2014 was 6% respectively. It was not changed at all. But, in 2015 the ROA dropped 2% from the two previous years which was 4%. Thus, the performance of UMB dropped drastically after they got high profit in 2012.



Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. Based on the graph above, the highest ROE was in 2012 while 2013 was the lowest one which 12% and 4% respectively. In 2014 and 2015, the return on equity were same. In findings, the performance of company could depends on internal and external factor. An example, size of board of director sometimes affects the profitability of the company as result of greater diversity in term of expertise. The study shows that ROA and ROE has a positive relationship between each other.

#### 4. DISCUSSION

##### i. Descriptive statistics of dependent and company specific variables

The mean of return on asset (ROA) for five years (N=5) of the United Malacca Bhd (UMB) is 6.72%. It is average profit of the company earns from the assets whereas the standard deviation of ROA shows that small variations in term of profitability with 2.91% (Table 1). The standard deviation is lower than mean indicates that the data points tend to be close to the mean (also called the expected value) of the set. For information, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility. Standard deviation

is a statistical measurement that sheds light on historical volatility. The findings, the lower standard deviation from the mean could due to the risk and profitability volatility is quite same year by year of UMB.

The mean of the liquidity of the UMB is 16.6807 while the standard deviation is 7.6082 (Table 1). This shows that the standard deviation is low not so far from average. In addition, UMB shows the mean of average collection period is 136.5805 whereas the standard deviation is 52.8109. This could be explained that the company experienced vary of the credit risk exposure. In addition, the study included four macroeconomic variables for UMB namely Growth Domestic Product (GDP) mean 5.300, Inflation mean 2.440, Exchange Rate mean 3.4600 and unemployment rate mean 3.0660.

## ii. Correlation

Table 2 exhibits the result of the Pearson correlation of UMB's variables. The findings of this study shows that ROA is negatively with the liquidity ratio (LIQUID) with 1 and -0.0365 respectively. Means that the more profit the company earn the less cash they have. So, this study shows is contradictory to the findings of previous studies which are Ghazali (as cited in Waemustafa and Sukri, 2013), who found a positive relationship between liquidity and ROA.

Besides, ROA compared to ROE is 90.03 % related (Table 2). So, this relationship is a positive relationship between dependent due to ROE increase when ROA increase. Other than that, the ROA and leverage ratio is a negative relationship which are 1 and -0.383 respectively (Table 2). This could due to the company earn more profit, at the same time more money the company borrowed. Besides, remuneration, average collection period and GDP show a positive relationship with ROA (Table 2). The GDP is positively to ROA because of the positive economy growth that make the UMB earn more profit. However, size, operating ratio, debt ratio, inflation, exchange rate and unemployment rate are negatively to ROA.

For information, the really positive or significant can be measure by using P-value. The P-value is significant must not more than 0.1. In UMB the really positive or significant are index score 0.000, size 0.008, ROE 0.000, and exchange rate 0.078 (Table 2). However, inflation, GDP, unemployment rate, current ratio, operational ratio, average collection period and debt ratio are not relevant.

### iii. Coefficient

Table 3 shows a coefficient of United Malacca Bhd. There are two suggestion model of coefficient of UMB which are Model 1 and Model 2. The coefficient suggest that model two is the best model compared to Model 1 because it have more variables and have more significant. Coefficient is a bit extra compared to correlation that tell us about significant, beta which direction relationship influence whether positive influence or negative influence and t-value about how big is the influence.

According to table 3, t-value of ROE have a big influence to the company which is 140.240 while the significant is 0.000. Normally, the smaller number of significant, the biggest of t-value. In the findings, the beta of ROE is 0.971 indicates that it is positive influence to the company. However, the leverage ratio have negative influence to the company. The number of significant of leverage ratio is 0.007 while the t-value is -11.999. So, the company must manages two main things in the company which are return on equity and leverage ratio. This is because these two are the only relevant variables among other variables. Based on the SPSS statistic, the most significant is return on equity followed by leverage ratio.

## 5. CONCLUSION

United Malacca Berhad is an industry plantation. The company core business are oil palm cultivation and crude palm oil milling. Corporate governance of the company was not doing sowell during five years ago which in 2011 until 2015. This is because, the profit decreased year by year.

In my view, the company has been facing drastically decreased of profitability during five years ago. Moreover, the company also short of cash even though the company earn more profit. This could due to the liquidity ratio was a negative relationship with profitability. Other than that, ROA and leverage ratio was a negative relationship. Meaning that the company earn profit, however, at the same time the company borrowed money too much. The relationship between ROA and ROE was a positive relationship. Meaning that when ROA increased, ROE also increased. So, the findings show that, UMB was not doing so well because their profitability decreased year by year.

In SPSS statistics suggest that UMB should manage two main things which are return on equity and leverage ratio. This is because, these two main variables give big influence to the company performance. ROE and leverage ratio are the only relevant variables among other variables. Based on the SPSS statistic, the most significant is return on equity followed by leverage ratio.

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## APPENDIX

TABLE 1: DESCRIPTIVE STATISTICS

<b>Descriptive Statistics</b>			
	Mean	Std. Deviation	N
ROA	0.0671918429820	0.02909811313328	5
INDEX SCORE	0.909090909100	0.0000000000000	5
BOD_REMU	1533600.00	615933.681	5
SIZE	1066339600.00	140890734.885	5
ROE	0.0708174482600	0.02984641009981	5
AVG.COLLECTION PERIOD	136.5804776140	52.81085850343	5
OPERATING RATIO	0.1466418712100	0.10691560766672	5
LEVERAGE RATIO	0.0626441327080	0.02882403900732	5
CURRENT RATIO	16.68072453560	7.608229578513	5
GDP	5.300	0.4950	5
INFLATION	2.440	0.6693	5
EXCHANGE RATE	3.4600	0.49168	5
UNEMPLOYMENT RATE	3.0660	0.14758	5

TABLE 2: CORRELATION

		Correlations												
		ROA	INDEX SCORE	BOD_REMU	SIZE	ROE	AVG.COLLECTI ON PERIOD	OPERATING RATIO	LEVERAGE RATIO	CURRENT RATIO	GDP	INFLATION	EXCHANGE RATE	UNEMPLOYMENT RATE
Pearson Correlation	ROA	1.000		0.287	-0.944	0.997	0.515	-0.457	-0.383	-0.365	0.327	-0.354	-0.737	-0.563
	INDEX SCORE		1.000											
	BOD_REMU	0.287		1.000	-0.091	0.334	-0.479	-0.095	0.496	-0.569	0.180	0.495	-0.399	-0.261
	SIZE	-0.944		-	1.000	-0.917	-0.700	0.286	0.634	0.221	-0.178	0.620	0.513	0.300
	ROE	0.997		0.334	-0.917	1.000	0.450	-0.504	-0.309	-0.416	0.331	-0.296	-0.785	-0.617
	AVG.COLLECTI ON PERIOD	0.515		-	-0.700	0.450	1.000	0.231	-0.961	0.515	0.336	-0.662	0.085	0.142
	OPERATING RATIO	-0.457		-	0.286	-0.504	0.231	1.000	-0.369	0.754	0.188	0.049	0.876	0.854
	LEVERAGE RATIO	-0.383		0.496	0.634	-0.309	-0.961	-0.369	1.000	-0.517	-0.129	0.771	-0.277	-0.379
	CURRENT RATIO	-0.365		-	0.221	-0.416	0.515	0.754	-0.517	1.000	0.447	0.001	0.702	0.526
	GDP	0.327		0.180	-0.178	0.331	0.336	0.188	-0.129	0.447	1.000	0.468	-0.198	-0.339
	INFLATION	-0.354		0.495	0.620	-0.296	-0.662	0.049	0.771	0.001	0.468	1.000	-0.090	-0.284
	EXCHANGE RATE	-0.737		-	0.513	-0.785	0.085	0.876	-0.277	0.702	-0.198	-0.090	1.000	0.944
	UNEMPLOYMENT RATE	-0.563		-	0.300	-0.617	0.142	0.854	-0.379	0.526	-0.339	-0.284	0.944	1.000
Sig. (1-tailed)	ROA		0.000	0.320	0.008	0.000	0.187	0.219	0.262	0.273	0.296	0.279	0.078	0.161
	INDEX SCORE	0.000		0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
	BOD_REMU	0.320	0.000		0.442	0.292	0.207	0.440	0.198	0.159	0.386	0.198	0.253	0.336
	SIZE	0.008	0.000	0.442		0.014	0.094	0.320	0.125	0.360	0.387	0.132	0.189	0.312
	ROE	0.000	0.000	0.292	0.014		0.224	0.193	0.306	0.243	0.293	0.314	0.058	0.134
	AVG.COLLECTI ON PERIOD	0.187	0.000	0.207	0.094	0.224		0.354	0.005	0.187	0.290	0.112	0.446	0.410
	OPERATING RATIO	0.219	0.000	0.440	0.320	0.193	0.354		0.271	0.071	0.381	0.469	0.026	0.033
	LEVERAGE RATIO	0.262	0.000	0.198	0.125	0.306	0.005	0.271		0.186	0.418	0.064	0.326	0.265
	CURRENT RATIO	0.273	0.000	0.159	0.360	0.243	0.187	0.071	0.186		0.225	0.499	0.093	0.181
	GDP	0.296	0.000	0.386	0.387	0.293	0.290	0.381	0.418	0.225		0.213	0.375	0.289
	INFLATION	0.279	0.000	0.198	0.132	0.314	0.112	0.469	0.064	0.499	0.213		0.443	0.322
	EXCHANGE RATE	0.078	0.000	0.253	0.189	0.058	0.446	0.026	0.326	0.093	0.375	0.443		0.008
	UNEMPLOYMENT RATE	0.161	0.000	0.336	0.312	0.134	0.410	0.033	0.265	0.181	0.289	0.322	0.008	
N	ROA	5	5	5	5	5	5	5	5	5	5	5	5	5
	INDEX SCORE	5	5	5	5	5	5	5	5	5	5	5	5	5
	BOD_REMU	5	5	5	5	5	5	5	5	5	5	5	5	5
	SIZE	5	5	5	5	5	5	5	5	5	5	5	5	5

ROE	5	5	5	5	5	5	5	5	5	5	5	5	5
AVG.COLLE CTION PERIOD	5	5	5	5	5	5	5	5	5	5	5	5	5
OPERATIN G RATIO	5	5	5	5	5	5	5	5	5	5	5	5	5
LEVERAGE RATIO	5	5	5	5	5	5	5	5	5	5	5	5	5
CURRENT RATIO	5	5	5	5	5	5	5	5	5	5	5	5	5
GDP	5	5	5	5	5	5	5	5	5	5	5	5	5
INFLATION	5	5	5	5	5	5	5	5	5	5	5	5	5
EXCHANGE RATE	5	5	5	5	5	5	5	5	5	5	5	5	5
UNEMPLOY EMENT RATE	5	5	5	5	5	5	5	5	5	5	5	5	5

TABLE 3: COEFFICIENTS

Model	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1 (Constant)	-0.002	0.003		-0.481	0.663		
ROE	0.972	0.045	0.997	21.698	0.000	1.000	1.000
2 (Constant)	0.005	0.001		7.091	0.019		
ROE	0.947	0.007	0.971	140.240	0.000	0.904	1.106
LEVERAGE RATIO	-0.084	0.007	-0.083	-11.999	0.007	0.904	1.106

a. Dependent Variable: ROA