# The Role Of Corporate Governance And Its Impact On Risk And Firm Performance Of Real Estate Industry: Pavilion Reit

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## ABSTRACT

The main purpose of this study is to identify corporate governance and its impact on firm performance of Real Estate Investment Trust over the period between 2011 and 2015. The study is to show how the firm performance influenced by corporate governance and risk performance. The information acquired from yearly report of Pavilion REIT Management Sdn. Bhd.( Pavilion REIT) from 2011 until 2015. The estimation of liquidity ratio and operating ratio used to see the general performance of Pavilion REIT in 5 years. The extra estimation is the asset size, this variable has a negative and no significant relationship with liquidity risk. To see the relationship of risk elements to the firm performances, this paper is using profitability ratio, liquidity ratio, activity ratio, leverage ratio, and Gross Domestic Product (GDP). This study will identify and explore about the risk that the company faced that affect the performances of the company like credit risk, liquidity risk and market risk. At the end of this study, the finding shows that the relationship between the corporate governance and risk performance and its impact on the Pavilion REIT Management Sdn. Bhd.'s financial performances. Thus to address this, the relationship between corporate governance, risk performance and firm performance are observed.

**Keywords: Credit Risk, Liquidity Risk, Profitability Risk and Macroeconomics**

# 1.0 Introduction

## 1.1 Background of Company

Pavilion Real Estate Investment Trust Management Sdn. Bhd. (Pavilion REIT) is one of the biggest retail of real estate in Malaysia. The Company is invest directly and indirectly during a distributed portfolio of financial gain manufacturing real estate used for retail functions including mixed-use developments with a retail component in Malaysia and different countries inside the Asia-Pacific region as property related assets. The company operates through two segments which is retail and office. The primary objective of Pavilion REIT is to give unitholders with regular and stable distributions and accomplish long-run growth in net asset value per unit whereas maintaining an acceptable capital structure.

The company involve in certain risk in the business operation which are credit risk, liquidity risk and market risk. As we know, the more risk occurred during the business operation, the more difficult the company to achieve its goals. Credit risk is the uncertainty of a money related misfortune to Pavilion REIT if the counter party or tenant to a financial instrument neglects to meet its legally binding commitments.

Pavilion REIT introduced to credit risk emerges primarily from trade and other receivables and money counterparts. The most exposure to credit risk arising from financial asset described by the carrying quantity of financial asset within the statement of financial position. Liquidity risk is that the risk that Pavilion REIT would not able to meet its financial obligation as they fail due. Pavilion REIT's exposure to liquidity risk arises chiefly from its numerous liabilities and borrowings. The manager maintains level of cash and cash equivalent and bank facilities deemed equal to finance Pavilion REIT's operations. This is to distribute financial gain to unitholders, it is also minimize and mitigate risk of fluctuation in cash flow. Additionally, manager monitors and observes the Securities Commission's pointers on property fund regarding limits on total borrowings finance.

This company also involve in market risk. The risk is related to the changes in market prices such as interest rates which will give impact to financial cash flow of the Pavilion REIT. Pavilion REIT's exposure to changes in interest rates relates mainly to interest earning financial assets and fixed costs financial liabilities. The rate risks are uncertainties ensuing from the consequences of fluctuations within the prevailing level of the market interest rates on its financial position and cash flows rate of interest risk exposure to Pavilion REIT is in respect of short-run deposits and borrowings.

The manager of this company understands the essentialness of guaranteeing an adequate and effective risk management and interior control framework, and has taken care of this under the Pavilion REIT Operation Manual endorsed by the Board. The Audit Committee and Board meet in any event once every quarter to review the financial related execution of Pavilion REIT against the endorsed spending plan. The Board likewise look for the business risk of Pavilion REIT, where recognized by the Chief Executive Officer (CEO) internal and external auditor and acts as needs be regarded properly.  Board's endorsement is required for any proposed procurement or transfer of speculation property, which would be assessed from the part of economic, environment, financial and risks applicable to the property business. The CEO meets the administration frequently to review, monitor and oversee risk recognized by the administration and from that point, refresh the Audit Committee as required.

The Board received statement from the CEO that the risk management and internal control framework condition whether it is working sufficiently and viably, in every single material perspective. The Board is of the view that the risk management and internal control framework set up is satisfactory successful. It will dependably be amended, enhanced and refreshed in accordance with changes in the working condition. Because of innate confinements, the controls which are utilized are planned to adapt and are not anticipated that would dispense with all risk of inability to accomplish business goals.

## 2.0 Literature Review

There are numerous researchers that do a research about corporate governance and firm performances. According to Waemustafa (2013) and Waemustafa and Sukri (2013), there is got to perceive how credit risk is created in Islamic banks and conventional banks considering internal and external factors determinants. Kolapo et al. (2012) and Kithinji (2010) concluded that the formation of credit risk embody, inappropriate credit policies, poor lending practices, restricted institutional capability, fluctuate in rate of interest, bad management, inappropriate laws, direct lending, massive licensing of banks, low capital and liquidity risk, laxity in credit assessment, poor loan underwriting, poor lending practices, inadequate management by central banks, interference of government and inadequate data concerning borrowers. The study provides deepen review of literature concerning to the banks specific factors and economic science factors that give impact on credit risk in Islamic banking and conventional banks.

The liquidity is the cause of the variety of failure in Islamic banks and conventional banks alike despite having access to external liquidity of conventional banks (Ali, 2004). This section exhibits the results of scrutiny the variations of the determinants of credit risk between Islamic banks and conventional banks from the angle of banks specific factors and economics variables (Waemustafa, W., & Sukri, S. 2015). The Shariah Supervisory Board ought to put exceedingly worry concerning any method of financing by the Islamic bank in which are not adjusted to the benefit sharing standards (Waemustafa, W., & Abdullah, A., 2015). Jurisprudence superior Board (SSB) is one in all internal governance mechanisms that involves the observance of Islamic banks' activities in accordance to the jurisprudence like Islamic law specifically on its implementation and compliance (Alman, M., 2012).

It is an area of the large company governance framework and what makes it totally different is just by the existence of jurisprudence superior Board or jurisprudence superior Committee or shariah unit (Rahajeng, D. K., 2012). Some studies argued that the distinctive attributes of SSB should be processed on incorporating SSB as a part of company governance mechanisms framework. Though the existence of SSB appeared ready to monitor Islamic banking activities, there are still Islamic banks have been failure the same as that of conventional within the recent year. Supposedly, by the attaining of shariah law and smart company governance, monotheism bank primarily ready to come through shariah law objectives (i.e., Maqasid Shariah). However, having this type of committee is sort not like providing reliable shariah law Governance within which utmost necessary and helpful to all or any parties within and outdoors the Islamic Banks by (Grais, W. and Pellegrini, M., 2006) and (Farook, S., Hassan, K., & Lanis, R., 2011).

The management of liquidity risk is just unreliable without proper information of risk formation in Islamic mode of finance. It is important to at first determine the method of risk formation before continuing to the next stage of risk management process (Muljawan, 2005). Islamic banks treat the idea of profit and loss sharing wherever the principle and agent relationship is on the basis of capital provider and businessperson. This mode of finance permits capital supplier and entrepreneur to share the benefit from the ventures undertaken supported an in agreement or mutual ratio. This participative nature permits real business activities for the actual fact that each parties ought to bear the profit or loss that may be shared supported the in agreement share (Sundararam and Errico, 2002).

Liquidity might throw solvent bank into bad economic condition since it has to sell its assets way below their price to fulfill its current financial obligations. The management of risk at the grass root level permits Islamic bankers to require preventive instead of reactive measure once handling risks. The development of risk in capital arrangement that the Islamic banks are confronting, for example, the liquidity dangers for Qard Hasan where this method of store instrument fills in as a sparing record for Islamic banks (Waemustafa, W., and Sukri, S., 2016). It may be projected that managers will de-emphasize innovation, preferring the lower, instead of the high risk/high return of an innovation strategy. By means of distinction, stockholders, as a result of they will balance risky stocks against low-risk stocks in their portfolio, are seemingly to prefer a stress upon innovation (Hill, C. W., & Snell, S. A., 1988).

The high return comes from the quasi-monopoly rents created by a productive innovation the high risk from the high failure rate of most innovations (Mansfield, 1968). As stockholders can enhance their own portfolios rapidly, and at low taken a toll, they don't have anything to pick up from broad enhancement, especially on the off chance that it bears pretty much nothing relationship to the company's current activities (Levy and Sarnat, 1970). Companies with a bigger market presence incur a lot of risk than smaller companies. The size may be thought of as either a dimension, or feature, of a company or as a context inside that managers operate (Kimberly, 1976).

## 3.0 Descriptive Analysis

The firm performances of Pavilion REIT Management Sdn. Bhd. are evaluated by ratios and risk of the company itself. These four types of ratios explored are profitability ratio, liquidity ratio, activity ratio, and leverage ratio. These ratios are to measure firm performance of the company. The profitability ratio consists of return on asset (ROA), return on equity (ROE), and return on investment (ROI). It is to measures how successful the company creating their profits. The liquidity ratio chosen in this study is current ratio. This ratio shows the company’s ability to meet day-to-day operating expenses and satisfy short-term obligations as they become due. The activity ratio focus on total asset turnover to measures how well the company is managing its assets. And the last one is leverage ratio that focuses on debt ratio of the company. This kind of ratio used interpreted the proportion of a company's assets that are financed by debt.

3.1 Profitability Ratio

**Return on Asset (ROA) = Net Profit After Tax/Total Asset**

**Return on Equity (ROE) = Net Profit After Tax/Stockholder's Equity**

**Return on Investment (ROI) = (Interest Income-Interest Expenses)/Interest Expenses**

| Year | Net Profit After Tax (RM'000) | Total Asset (RM'000) | Stockholder's equity (RM'000) | Interest Income (RM'000) | Interest Expenses (RM'000) | ROA | ROE | ROI |
|---|---|---|---|---|---|---|---|---|
| 2011 | 12,376 | 3,681,088 | 2,868,742 | 234,000 | 2,218 | 0.0043 | 0.0043 | -0.8945 |
| 2012 | 630,205 | 4,221,355 | 2,873,893 | 5,247 | 32,088 | 0.1493 | 0.2193 | -0.8365 |
| 2013 | 327,250 | 4,355,353 | 2,881,933 | 5,896 | 30,147 | 0.0751 | 0.1136 | -0.8044 |
| 2014 | 510,475 | 4,649,931 | 2,887,271 | 6,084 | 30,246 | 0.1098 | 0.7168 | -0.7988 |
| 2015 | 282,337 | 4,750,753 | 2,893,046 | 6,221 | 31,081 | 0.0594 | 0.0976 | -0.7988 |

3.1.1 Return on Asset

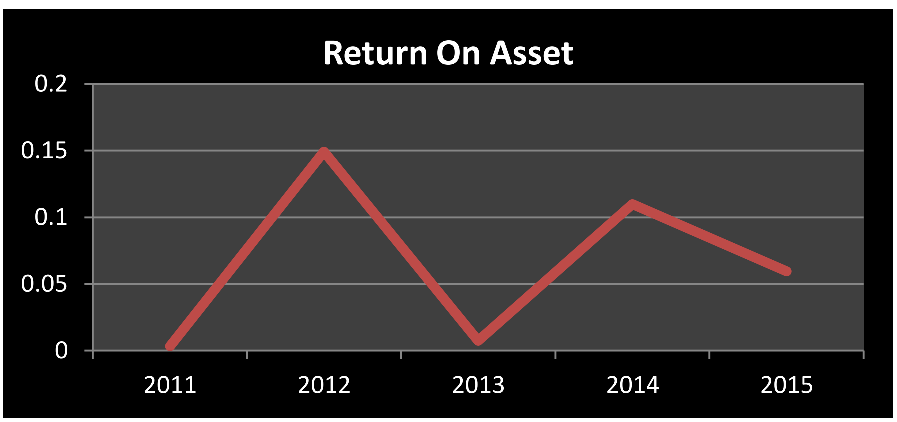


**Figure 1: Graph of Return on Asset**

The return on assets (ROA) ratio measures how effectively of Pavilion REIT can earn a return on its investment in assets. The higher the return, the more productive management is in using its asset base. The Figure 1 above illustrates an unsteady pattern on the return on assets from the year 2011 to 2015.Based on the graph of return on asset of Pavilion REIT, it can be conclude that, in year 2011 the company is not doing so well because as we can see here the ROA is the worst compared to the other years. It clearly seen that in year 2011, the ROA is only 0.34% / 0.0034 which is the lowest among the five years. From the year 2012 to 2013, it dropped from 14.93% / 0.1493 to 0.75% / 0.0075 by 14.18%. Then, it managed to rise to 10.98% / 0.1098 in the year 2014 and in year 2015 the ROA goes down at 5.94%. Overall, the ROA does not considered as good in year 2011 and 2013 because the company used less efficiently total asset to generate more income to the company. It shows that amount of profit earned in each dollar invested in asset in year 2012 is the best compared to other years. It means that management efficiency using the asset and stockholder's fund in 2012 is good.

3.1.2 Return on Equity

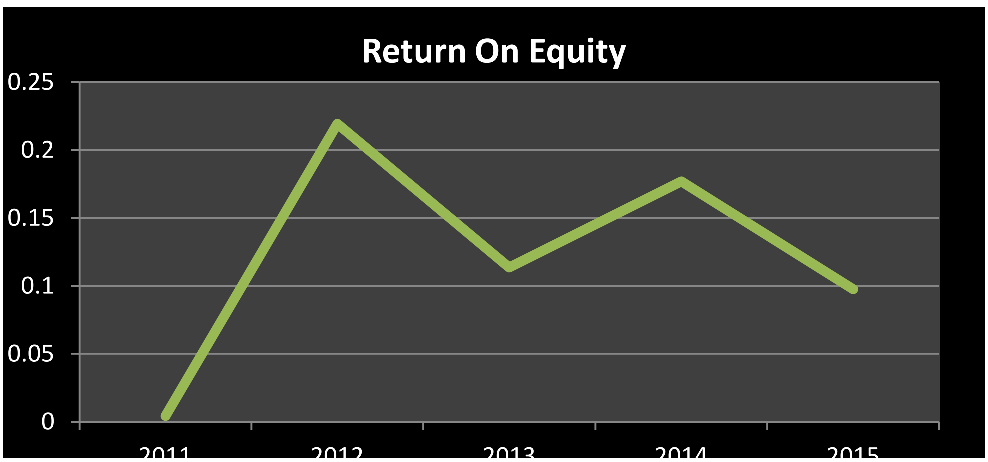


**Figure 2: Graph of Return on Equity**

Return on equity measures how efficiently a firm can use the money from shareholders to generate profits and grow the company. High return shows the better its company's performance. Based on the Figure 2, return on equity increase from 0.43% / 0.0043 in year 2011 to 21.93% / 0.2193 in the year 2012. Then, it is decline to 11.36% / 0.1136 in year 2013 So, the ability in using the shareholder's money to generate income also had been decreasing. The ratio increases again in 2014 to 17.68% / 0.1768 by 6.21%. In year 2015, the return on equity dropped to 9.76% / 0.0976. Return on equity in year 2012 is the best with the highest ratio among others. It shows how well Pavilion REIT use investment funds to generate their earnings growth of the company.

### 3.1.3 Return on Investment

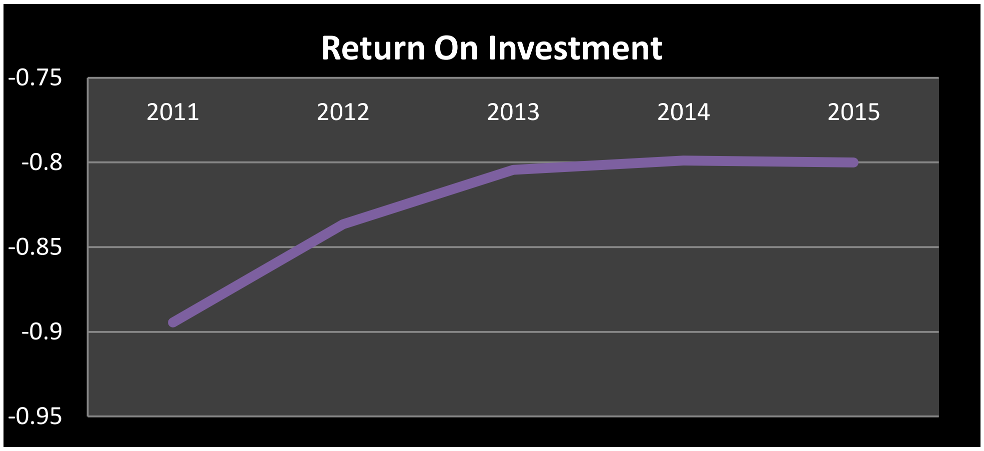


**Figure 3: Graph of Return on Investment**

Return on Investment (ROI) is typically expressed as a proportion and is usually used for private financial decisions to check a company's profitableness or to match the potency of various investments. The Figure 3 above shows a return on investment of Pavilion REIT from the year 2011 to 2015. In year 2011, the return on investment of the company is -0.8945 / -89.45%. The return then slightly goes up in year 2012 to -83.65% / -0.8365. From year 2013 to 2014 the return on investment increases from-80.44% / -0.8044 to -79.88% / -0.7988. It then increase in a small change by 0.0068 which at 0.1872 in year 2015. It can be concluded that the ROI in year 2014 is the best compared to other years.

## 3.2 Liquidity Ratio

### 3.2.1 Current Ratio

**Current Ratio = Current Asset/ Current Liabilities**

| Year | Current Asset (RM) | Current Liabilities (RM) | Current Ratio |
|---|---|---|---|
| 2011 | 116,521,000 | 40,660,000 | 2.8567 |
| 2012 | 206,325,000 | 195,048,000 | 1.0559 |
| 2013 | 219,767,000 | 61,009,000 | 3.6022 |
| 2014 | 215,096,000 | 61,082,000 | 3.5214 |
| 2015 | 201,593,000 | 115,667,000 | 1.7429 |

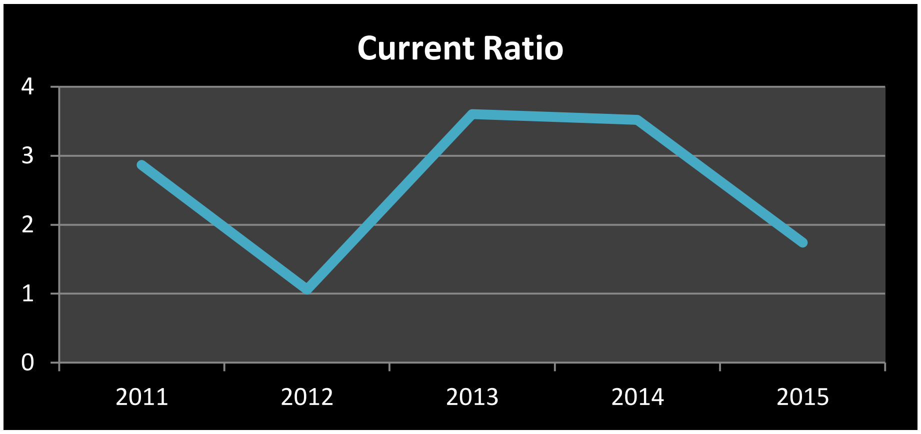


**Figure 4: Graph of Current Ratio**

The current ratio is a liquidity ratio that measures a company's ability to pay short-term obligations. Based on the Figure 4, the liquidity ratios of Pavilion REIT shows that current ratio from 2011 to 2015 fluctuated over a time. The amount of current ratio in year 2011 is 2.8657 and fall at 1.0559 in year 2012. It start to goes up to 3.6022 in year 2013 then dropped in small amount in year 2014 to 3.5214 by 8.08%. The current ratio continues to decline to 1.7428 in year 2015. Even though it shows a bad sign the company it is still stable because the current ratio is more than 1. It means that the company is able to pay back the short term debt in a short period of time.

3.3 Activity Ratio

3.3.1 Total Asset Turnover

**Total Asset Turnover = Annual Sales/Total Asset**

| Year | Annual Sales (RM) | Total Asset (RM) | Total Asset Turnover |
|---|---|---|---|
| 2011 | 22,539,000 | 3,681,088,000 | 0.0061 |
| 2012 | 346,524,000 | 4,221,355,000 | 0.0821 |
| 2013 | 375,509,000 | 4,355,353,000 | 0.0862 |
| 2014 | 402,092,000 | 4,649,931,000 | 0.0865 |
| 2015 | 413,932,000 | 4,750,753,000 | 0.0871 |

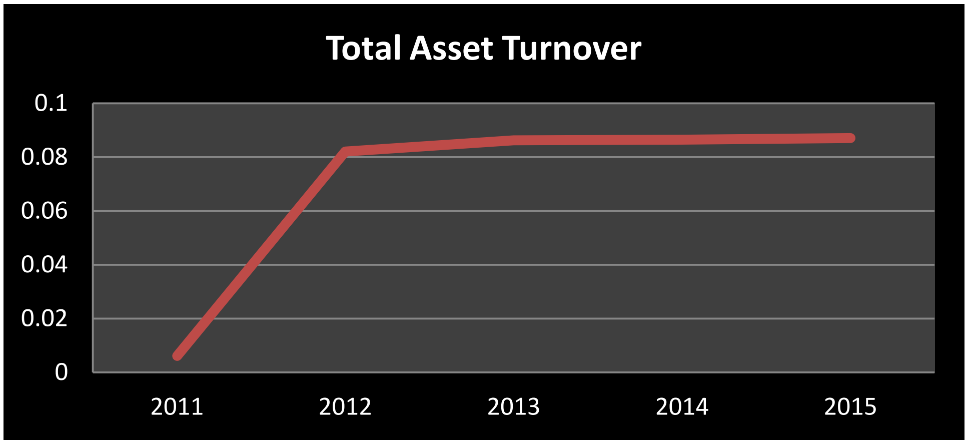


**Figure 5: Graph of Total Asset Turnover**

Total Asset Turnover shows how efficiently the company is using its assets to support sales. Based on Figure 5, total asset turnover show a positive result as it increase from the year 2011 to 2012 from 0.0061to 0.0821 respectively. It continues to rise in year 2013 to 0.0862. After that, it is slightly increase in year 2014 to 0.0865. The total asset turnover rise again with the amount of 0.0871 in year 2015.From the pattern of the graph, we can concluded that the total asset turnover for Pavilion REIT is doing good as it increase year by year. The higher the ratio means the company is efficient in using the assets. From this graph the most favourable total asset turnover is in the year 2015 since it has the highest percentage.

3.4 Leverage Ratio

3.4.1 Debt ratio

**Debt Ratio = Total Liabilities/Total Asset**

| Year | Total Asset (RM) | Total Liabilities (RM) | Debt Ratio |
|---|---|---|---|
| 2011 | 3,681,088,000 | 813,110,000 | 0.2209 |
| 2012 | 4,221,355,000 | 924,245,000 | 0.2189 |
| 2013 | 4,355,353,000 | 831,937,000 | 0.1912 |
| 2014 | 4,649,931,000 | 838,915,000 | 0.1804 |
| 2015 | 4,750,753,000 | 899,146,000 | 0.1872 |

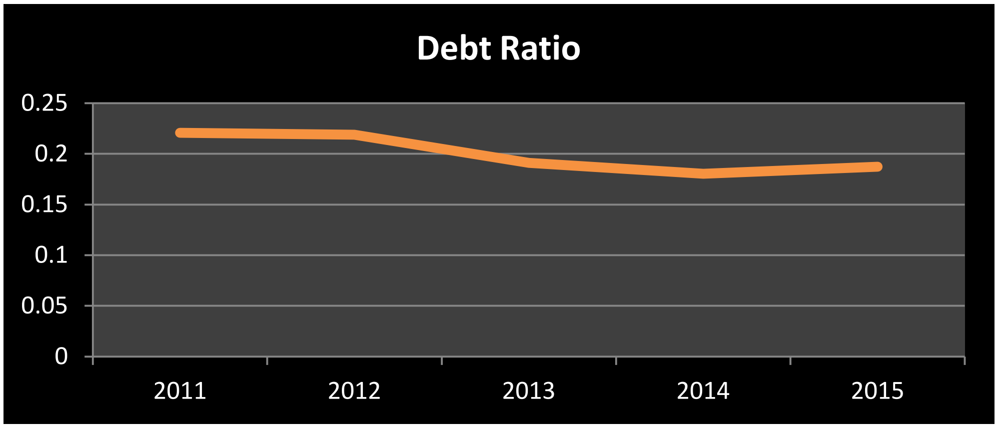


**Figure 6: Graph of Debt Ratio**

Debt Ratio measure how much debt the company is using to support its business. The graph of debt ratio of Pavilion REIT shown is calculated by total liabilities divided by total assets. A lower debt ratio for the most part suggests a more steady business with the capability of life span in light of the fact that an organization with lower proportion has a lower overall debt. Based on Figure 6, the debt ratio decreases from 0.002 to 0.2189 in year 2011 until 2012 respectively. After that, it is dropped to 0.1912 in year 2013 but in a small change which is 0.0277. It managed to decline again for the year 2014 to 0.1804 then jump to 0.1872 in year 2015. As we can see that the debt ratio is quite low so it shows that Pavilion REIT is less risky by managing its debt. Year 2014 is the best debt management as the lowest debt ratio among the other years.

3.5

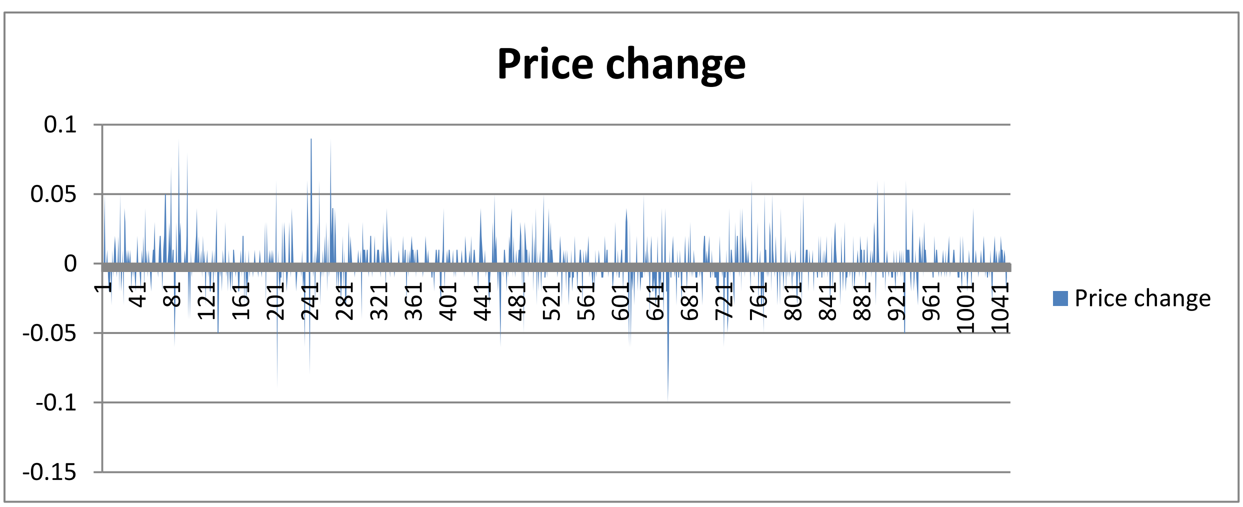


Figure 7: The graph shows the price change throughout the year 2011-2015

### Descriptive Statistics

| | Mean | Std. Deviation | N |
|---|---|---|---|
| ROA | .079400 | .0547829 | 5 |
| LIQUID | 2.5576 | 1.12181 | 5 |
| LEVERAGE | .2001 | .01851 | 5 |
| GDP | 5.4400 | .48785 | 5 |

### Correlations

| | | ROA | LIQUID | LEVERAGE | GDP |
|---|---|---|---|---|---|
| Pearson Correlation | ROA | 1.000 | -.355 | -.151 | .279 |
| | LIQUID | -.355 | 1.000 | -.497 | -.264 |
| | LEVERAGE | -.151 | -.497 | 1.000 | -.250 |
| | GDP | .279 | -.264 | -.250 | 1.000 |
| Sig. (1-tailed) | ROA | . | .279 | .404 | .325 |
| | LIQUID | .279 | . | .197 | .334 |
| | LEVERAGE | .404 | .197 | . | .342 |
| | GDP | .325 | .334 | .342 | . |
| N | ROA | 5 | 5 | 5 | 5 |
| | LIQUID | 5 | 5 | 5 | 5 |
| | LEVERAGE | 5 | 5 | 5 | 5 |
| | GDP | 5 | 5 | 5 | 5 |

The table above is show the correlation profitability ratio which is ROA and the others. From the index score, we can know that less efficient of the board, the more profit the company have

Lastly, from the leverage, the lesser the debt cause the more company profit in terms of correlation.

**Model Summary[b]**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|---|
| 1 | .519[a] | .269 | -1.924 | .0936795 | 2.039 |

a. Predictors: (Constant), GDP, LEVERAGE, LIQUID

b. Dependent Variable: ROA

This table contains the values of the R correlation coefficient at the level of of the entire of variables which form the regression models. It figured distinctly in each phase of the backward method of optimal assessment of linear regression. As it concerns our survey, because of the esteem ascertained for the R relationship coefficient R=0.5193, we can express that express that the autonomous factors distinguished inside model 1 (Total debt turnover, ratio between the Cash flow and the turnover, and EBIT margin) are those which illuminate best the advancement of the dependent variable..

**ANOVA[a]**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | .003 | 3 | .001 | .123 | .935[b] |
| | Residual | .009 | 1 | .009 | | |
| | Total | .012 | 4 | | | |

a. Dependent Variable: ROA

b. Predictors: (Constant), GDP, LEVERAGE, LIQUID

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. | Collinearity Statistics | |
|---|---|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | | Tolerance | VIF |
| 1 | (Constant) | .383 | 1.172 | | .327 | .799 | | |
| | LIQUID | -.027 | .054 | -.558 | -.502 | .704 | .591 | 1.691 |
| | LEVERAGE | -1.248 | 3.278 | -.422 | -.381 | .768 | .596 | 1.678 |
| | GDP | .003 | .112 | .026 | .026 | .983 | .737 | 1.358 |

## 4.0 Discussion and Recommendation

During year 2011 to 2015, performance of Pavilion REIT was indicating great in the performances result for all estimations of liquidity and operation in yearly basis. The viable transformation resources into cash to reimburse the debt with no issue and the proficient operation without acquiring any extra costs are reflected to the general performance of the company. As we can see in the data in Figure 3, the return on investment of Pavilion REIT shows a negative result year by year. So, there should be an improvement in terms of profitability performance with the measurement of return on investment. The company must increase the company's income and reduce their expenses.

The initial phase in enhancing organization return on investment is to plainly characterize the potential return or returns the organization may get from investment. These can incorporate higher deals, expanded incomes, greater benefits, decreased overhead or creation costs, higher representative maintenance, better consumer loyalty, expanded brand inclination or less government controls. It is better for the company set different benchmarks for the arrival goals. For instance, rather than setting to increase annual sales as an objective, better to set sales that company want to achieve in a particular month. The company may cut the extra cost used in business operation to decrease the total expenses paid. This method is the more important than try to increase the company's revenue.

## 5.0 Conclusion

In conclusion, it is clear that liquidity risk, credit risk and market risk which included interest rate risk is faced by the company. Pavilion REIT could deal with the liquidity risk adequately and productively with the proportion is past and underneath the standard of benchmark. The liquidity and operational execution every year demonstrates this organization is not having issue to settle the commitment of debt and works proficiently that could increase its profit. Furthermore, the company has to maintain the performance onwards. From the findings, there is one of variable is the most significant the company should focused on which is ROA. This ROA as a profitability variable to the operation with the most astounding effect contrasted with all of factors like profitability, activity and leverage ratio. In this way, this organization ought to concern more to the corporate administration to diminish any wastefulness that lessening the capacity of an organization to increase more revenue. Likewise, to keep up and enhance persistent profitability of this organization, the execution of liquidity management ought to put into thought as a part of profitability contribution.

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