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# **Firm Risk and Performance: The Role of Corporate Governance in Dutch Lady Malaysia**

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## **Abstract**

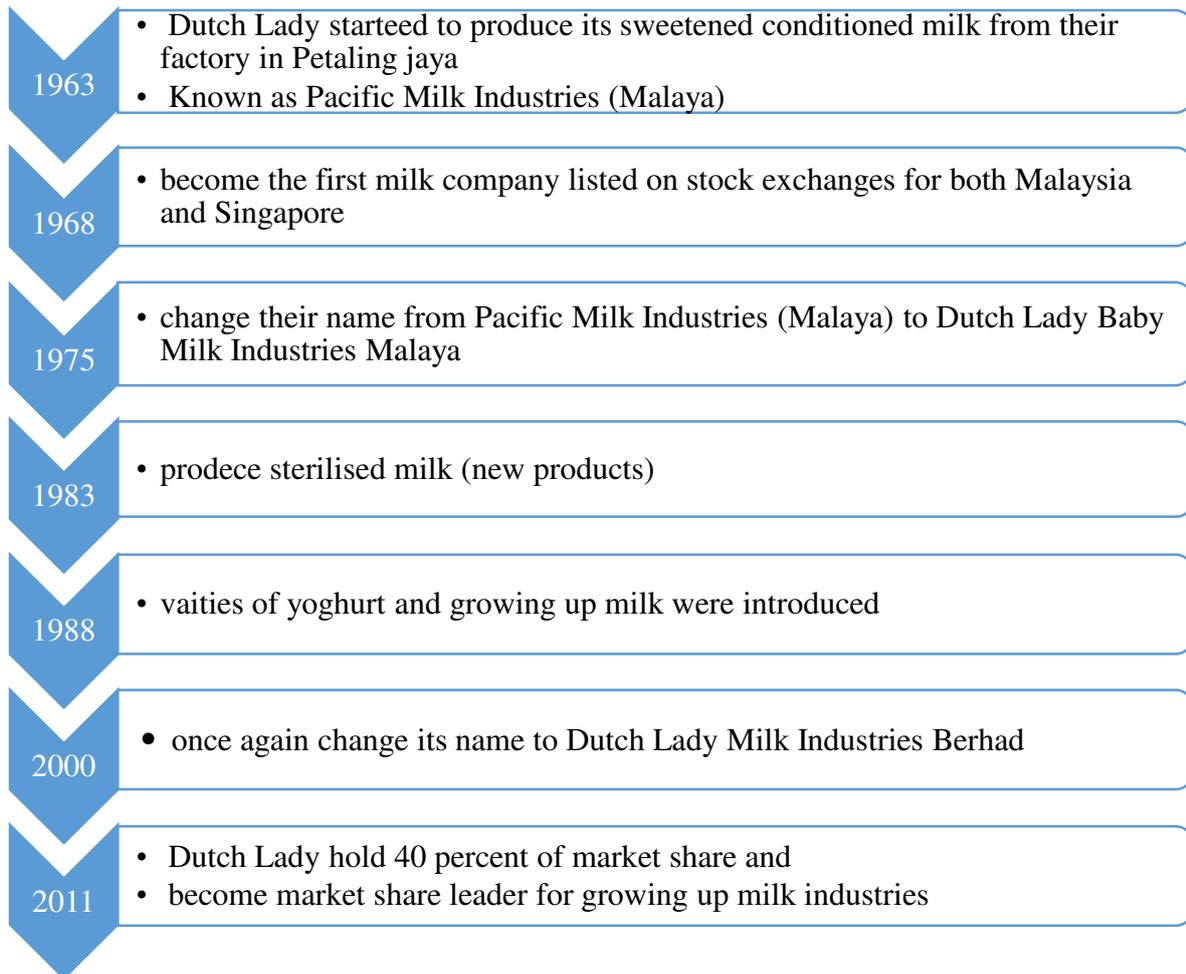
The objective of this paper to characterize some indicators of overall performance of Dutch Lady Malaysia with specific risk factors and macroeconomics factors (GDP, inflation rate) on return on assets (profitability). The information was collected from Dutch Lady Malaysia annual report for five consecutive year (2011-2015). A correlation model comprising dependent variable (ROA) and numerous independent variables was used to analyse performance of Dutch Lady Malaysia. This study empirical result indicated that liquidity ratio is the most significant meaning in performance of Dutch Lady Malaysia.

**Keywords: Specific Risk, Macroeconomics Factors, Return on Assets (ROA), Liquidity**

## **1.0 Introduction**

Dutch Lady owned by Dutch parent company which known as Royal FrieslandCampina. Dutch Lady is a leading dairy company in Malaysia. Dutch Lady was first established at Petaling Jaya as a manufacturer of sweetened condensed milk in 1960. Dutch Lady still operating from the same production plan in Petaling Jaya. However, Dutch Lady have expanded their range of quality and delicious dairy product. Dutch Lady products which are Dutch Lady Purefarm UHT milk, Friso Gold and formulated milk powder for children Dutch Lady Nutriplan with 5X DHA, are distributed to peninsular and East Malaysia. Dutch Lady have about 600-strong employees with aims to help Malaysians move forward in life with trusted dairy nutrition. (Dutch Lady, 2015)

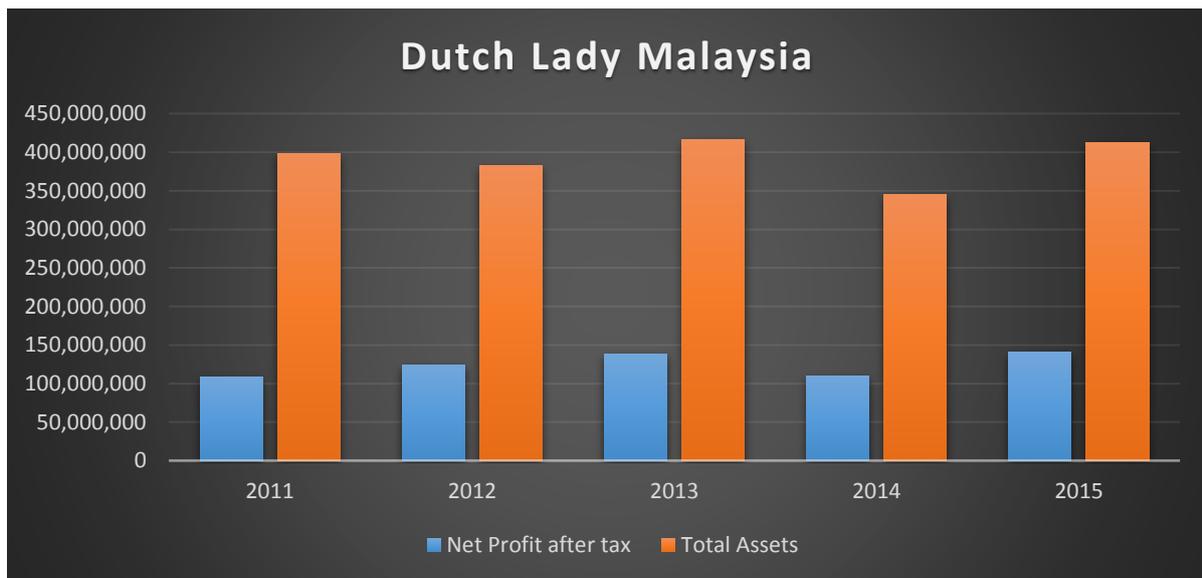
## 1.1. History



With 22,000 employees, 100 offices around the world, plus 600 work-force in Malaysia and around 400 scientists it shows that Dutch Lady have taken seriously to achieve their own Vision and Mission which are “to strengthen our position as the leading dairy company, driving growth” and “helping Malaysians move forward in life with trusted dairy nutrition”.

Dutch Lady had provided RM500,000 sponsorships on 2012 for 10 winners in their campaign ‘Jadi Bijak, Jadi Terkenal’. They also provide “Bantuan Susu 1 Malaysia” for students in primary schools. (Sinar Harian, 2012)

Dutch Lady current promotions are Dutch Lady Milky contest. This contest open for Malaysian with age of 18 and above however employees and immediate families of the organizer. This contest open between 2<sup>nd</sup> March 2017 until 15<sup>th</sup> March 2017. There will 10 grand prize and 20 consolation prize. The grand prize are four Disney On Ice Category 1 tickets plus meet and greet Disney On Ice Performers each. The consolation prize are two Disney On Ice Category 2 tickets. (Dutch Lady, 2017)



Graph 1: Net Profit After Tax and Total Assets

## 2.0 Literature Review

Diversification definition explained by Nasdaq (2011) are investors tend to invest in different type of assets and instruments in order to minimize total investment risk. Markowitz (1952) diversification theory verify that the function of the means, variances and pair –wise of risk assets are the optimal diversifications strategy. Contrary, Babylonian Talmud [1], the naïve diversification strategy theory recommend that a man should always place his money, one third in land, a third into merchandise and keep a third in hand. Later, Zweig (1988) suggest that, to minimize future regret, there should have fifty-fifty split between equities and bonds. However, Dutch Lady Malaysia does not invest in any investment instruments on the first three consecutive year. On 2014 and 2015, they start to invest in derivatives market and does not diversified or split their portfolio. Thus Dutch Lady facing a huge decrease on its return on investment. (Refer ROI Graph)

Liquidity define by Investopedia (2017) is the degree how quickly an assets or securities can be sold to the market without affecting the asset’s price. While profitability ratio (return on assets) define by Nasdaq (2011) is the indicator of profitability. Ghazali (2008) in his study verify that liquidity is negatively related to ROE but have positive relationship with ROA and NIM. Similarly, Waemustafa and Sukri (2016) find that liquidity ratio is positively significant with ROA. Contrary, Choon et al. (2012) in his studies find that, it is liquidity have negatively related to ROA. In other words, the more loans are given out as a ratio of deposits; the liquidity risk of the banks face rises, negatively affecting earning of the banks. (LIQ) is positive, but

insignificant factor of bank performance, when measured with ROE. However, my studies find that Dutch Lady Malaysia have a negative relationship between liquidity and ROA. The findings are same with Choon et al. (2012)

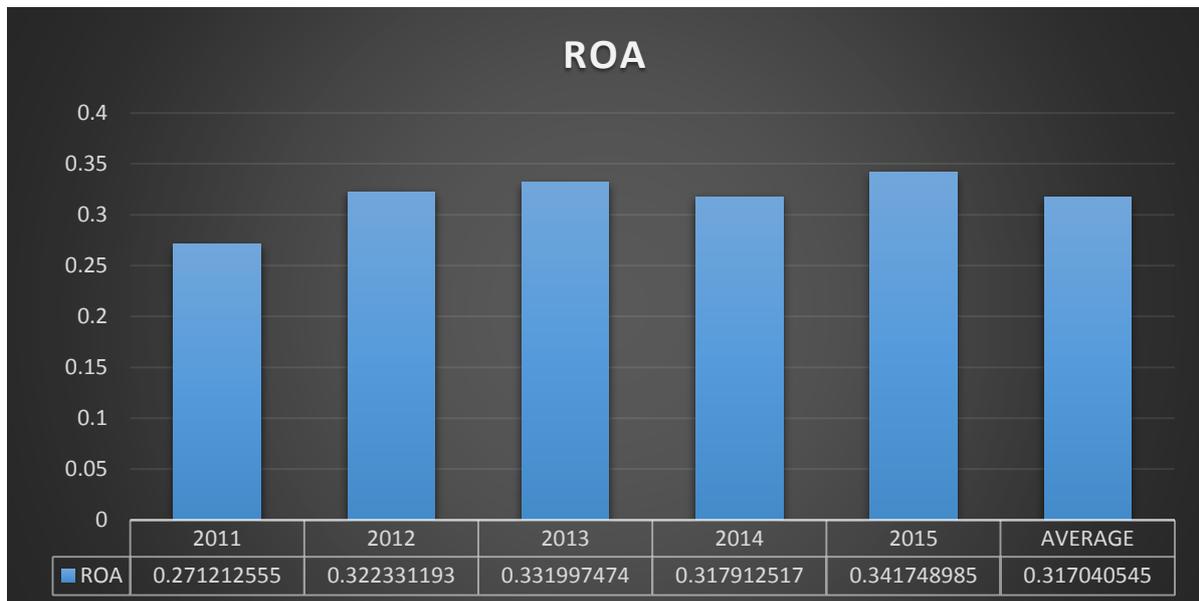
Investopedia (2017) define that inflation is the situation where the level of price of good and services keep increasing and affected the purchasing power of . Inflation are being control by the Central Bank. Waemustafa and Sukri (2015) find that there Inflation rate is negatively and significantly to credit risk for conventional banks with t value=-2.459 and significant at 0.001 level whilst in the case of Islamic banks, it is negative but not significant to credit risk. However, Dutch Lady Malaysia does not have any problem arise from inflation because Dutch Lady do not have credit risk. In the other hand, Dutch Lady have negative relationship between ROA and inflation on Malaysia.

Financial Times (2017) defines that, a Sharia supervisory Board or Sharia committee is established to advise and certify several financial products. Alman (2012) verified, Shariah Supervisory Board (SSB) is one of internal governance mechanisms which involves the monitoring of Islamic banks' activities in accordance to the Sharia (i.e. Islamic law) specifically on its implementation and compliance. In addition, Rahajeng and Kartika (2012) define that SSB It is a part of the big corporate governance framework and what makes it different is only by the existence of Shariah Supervisory Board or Shariah Supervisory Committee or Shariah unit. Bhatti and Bhatti (2010) verified that, Since Shariah governance is part of corporate governance, thus, good and effective SSB should reflect the issue of independence, transparent, accountable, responsible, and fair . however, Dutch Lady Malaysia does not establish any Sharia Supervisory Board maybe due to factor that Dutch Lady are from foreign country tht do not practice any Islamic supervisory

Board of directors is a group of person that are elected to represent the stockholders and to establish corporate management related policies and the most important part is to make decisions on a major company issues. Lipton and Lorsch (1992), Jensen (1993) verified that although larger board size initially facilitates key board functions, there comes a point when larger boards suffer from coordination and communication problems and hence board effectiveness and firm performance declines. Contridactory, Coles, Daniel and Naveen (2008) find that the impact of board size on firm value is positive for large firms, and hence large board size may be an optimal value maximizing outcome for such firms. Dutch Lady have 8 BOD and this make Dutch Lady to perform well.

### 3.0. Descriptive analysis

#### 1. Return on Assets



Graph 2 : Return On Assets

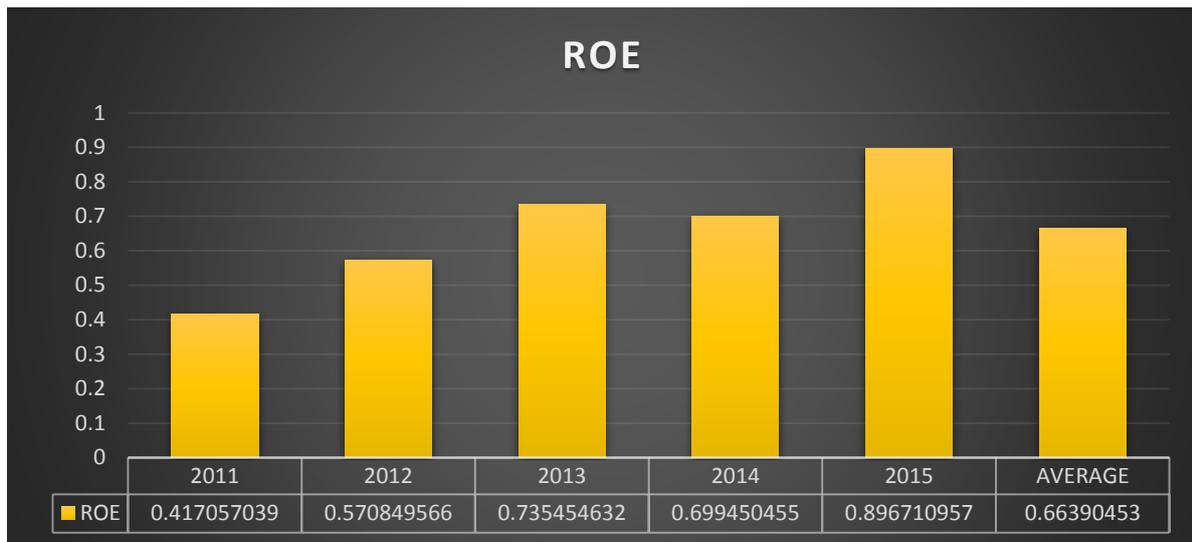
Return on assets is the indicator of profitability for an organization. The percentage of return on assets are derived from dividing net income of the company with total assets for one year. This ratio shows how efficient a company generate income using its assets.(Nasdaq, 2011)

Based on the Graph above, its show on 2011, Dutch Lady had the lowest return on assets which is 27%, while on 2012 until 2015, ROA shows almost the same percentage which were 30%

This shows that on 2011, 27% of income are generated using Dutch Lady average total assets for that year while on 2012 until 2015, around 30% of income were generated using average total assets for that four year.

Finally the average ROA for the five year were around 32% from the average total assets

## 2. Return on Equity



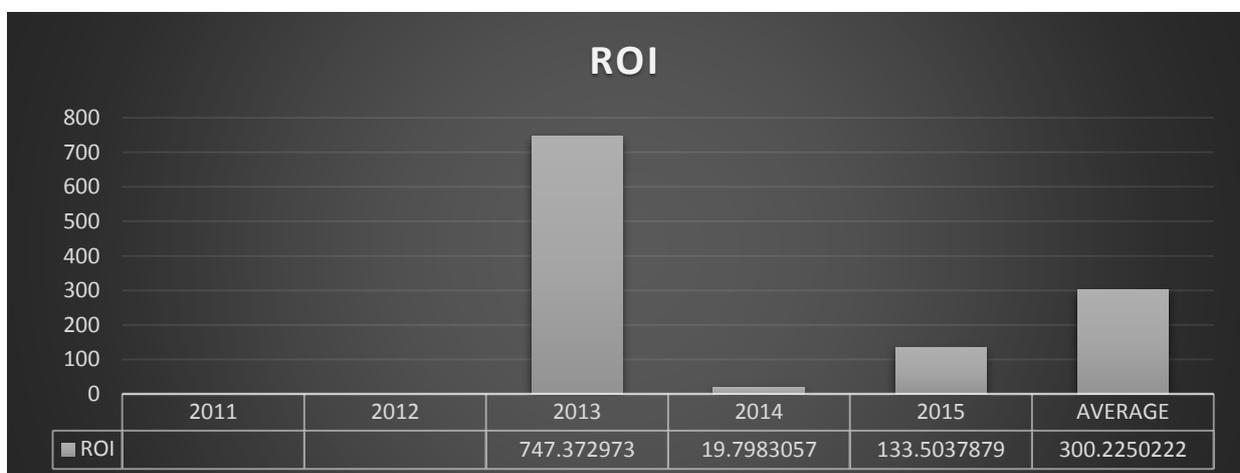
Graph 3: Return on Equity

Return on Equity is also a profitability ratio that measures how efficient a company use share holders investment to generate profit. The simpler definition for ROE is that how much return can be generated from each dollar of stockholder’s common equity. (My Accounting Course, 2017)

Dutch Lady ROE’s trends were increasing for the year of 2011 until 2013 but have a slightly decrease on 2014, however on 2015, ROE was the highest which was around 90% of income are generated from the total stockholder’s common equity. Dutch Lady lowest ROE was on the year 2011 which was only 42% of income are generated from the total stockholder’s common equity.

Finally, the average ROE for the five consecutive year was 66% from the total stockholder’s common equity.

## 3. Return on Investment



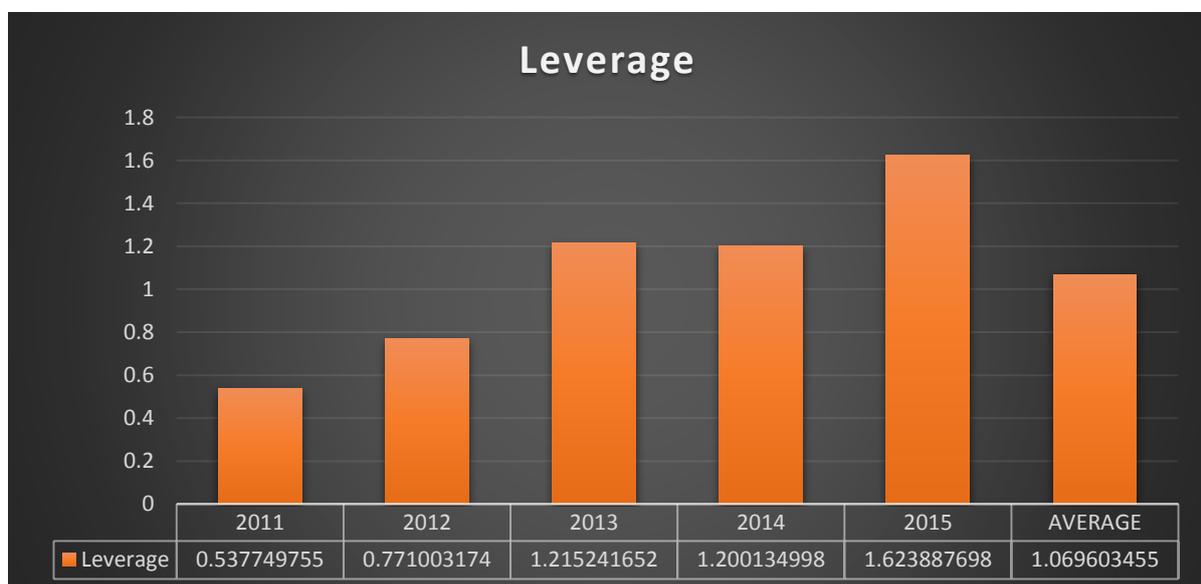
Graph 4: Return on Investment

Return on Investment is one of the profitability ratio. It shows how many percentage of return gain from the investment original cost. This ratio acts as benchmark for investor on how efficient a company invest in a project that produce profit. (My Accounting Course , 2017)

Based on the graph, on 2011 and 2012, Dutch Lady did not invest in any financial instrument. However, on 2013 they started to invest in derivatives market. Maybe due to the undiversified portfolio, on 2014 and 2015 the return on investment was decreased tremendously.

Finally the average for return on investment for the five year was half from the return of investment on 2013.

#### 4. Leverage

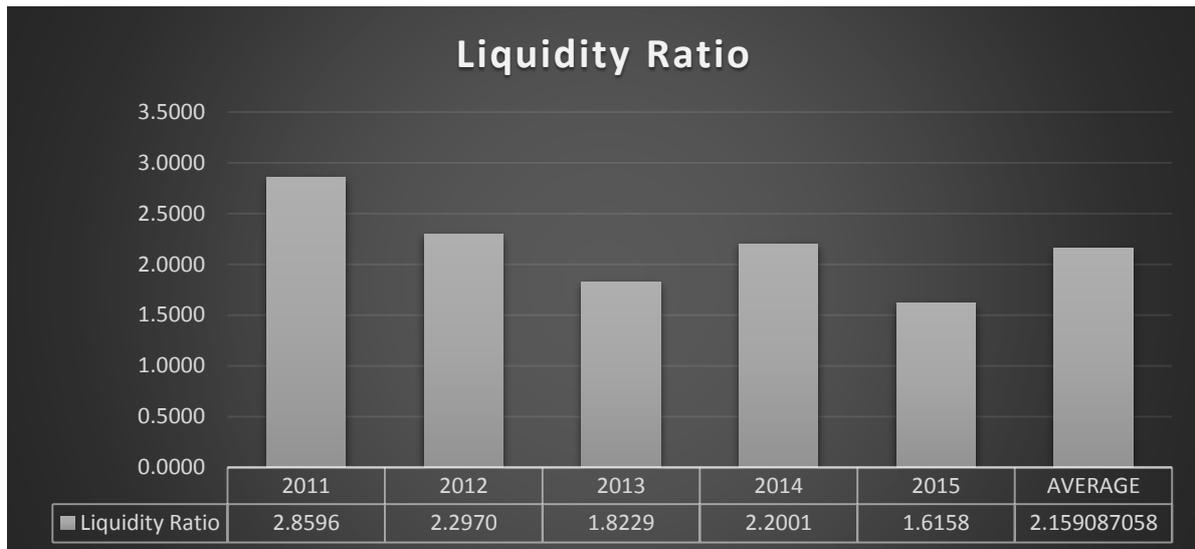


Graph 5: Leverage

Leverage or also known as debt to equity ratio is the shows how much a company is financed using debt and from investors. Higher ratio of leverage shows that the company have been financing mostly from debt/creditors, while lower ratio shows that the company have been financing mostly from the shareholder's investment. (My Accounting Course, 2017)

Based on the graph above, its shows that the leverage ratio were increasing for the five consecutive year. The highest leverage ratio was recorded on 2015 which were 1.62

## 5. Liquidity



Graph 6: Liquidity Ratio

Liquidity ratio is the measurement of the company ability to pay debt obligations. The higher the liquidity ratio the more liquid the company is and has a better coverage of its outstanding debt.

Dutch Lady lowest liquidity ratio was recorded on the year 2015. The best year for liquidity ratio was 2011

## 6. Operating Profit Margin



Graph 7 : Operating Profit Margin

Operating profit margin measures the ratio of revenue made up from the operating income. This ratio shows how much revenues are left after all cost are paid. This ratio are important to both investors an creditors because it measures how profitable a company are. The higher the

operating margin shows a good sign because it shows that the company can pay both fixed and variable cost. (My Accounting Course, 2017)

Dutch Lady operating profit margin were increasing for year 2011 until 2013, however on 2014 the operating profit margin decline and the increase slightly on 2015. This shows that Dutch Lady need to find new way to generate income.

#### 4.0 Discussion and Recommendation

##### Descriptive Statistics

	Mean	Std. Deviation	N
ROA	.3170405446 58039	.0272175160 34448	5
Net Profit after tax	124109400.0 0	15378285.49 6	5
Total Assets	391156200.0 0	28745462.57 6	5
Leverage	1.069603455 360012	.4235299506 08382	5
Liquidity Ratio	2.159087057 718919	.4794831054 61097	5
ROE	.6639045299 59336	.1803986367 45172	5
ROI	180.1350133 09501400	321.9233138 17435260	5
Operating Profit Margin	.3499974237 51413	.0151449266 54520	5
GDP	5.300	.4950	5
Inflation Rate	2.440	.6693	5
Remuneration (BOD)	1991800.00	747055.353	5

Table 1: Descriptive Statistics

The results of descriptive statistics for the variables are in table above. For average five years Dutch Lady Malaysia makes 31% profit from asset. Standard deviation quite small meaning that every year the company make profit not so far from average and it is good because it is not

volatile, because risk and profitability the company do not want volatility. Leverage tells that proportion of debt to equity, in the table above shows that every 1 ringgit of debt is sponsored by 1.07 of equity on average. For five consecutive years Dutch Lady Malaysia have an average of 2.16 liquidity ratio.

This study include two macroeconomic independent variable which is GDP 5.3 mean and Inflation rate 2.4 mean.

### Pearson Correlation

Table 2: Pearson Correlation (appendix)

Based on the table above we can see the relationship using Pearson Correlation between the variables and ROA. This study uses SPSS to see the relationship in correlation ROA as dependant variable with other variable. Based on table 4.2 net profit after tax is strong positive to ROA 80.4%, this means when ROA increase net profit after tax increase by 80.4%. It shows that net profit of Dutch Lady Malaysia is making profit more from its total asset.

Liquidity ratio has negative relationship with ROA -0.95. It mean that when ROA increase liquidity ratio decrease. This means Dutch Lady have high liquidity risk because many of the assets were fixed assets. So the ability for Dutch lady to convert its assets to cash are very hard.

Based on this Durbin Watson Pearson Correlation shows leverage ratio shows that positive relationship between ROA and leverage on average. Positive relationships shows that the company have higher return when debt increase.

Return on investment in average compared to ROA was .414, which is means that both variable have a negative relationship. This shows that, Dutch Lady, do not diversified their investment.

Remuneration in average was -.580. this shows that remuneration have negative relationship with ROA. The higher the remuneration the lower the ROA.

Macroeconomics variables that used are GDP and inflation rate. These both variable have weak relationship with ROA on average. this study shows the evident that that external factors does not affect too much on the performance of Dutch Lady Malaysia. It is because Dutch Lady Malaysia active in their export. That why Dutch Lady does not being affected by the external factors.

ANNOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.003	1	.003	30.238	.012 <sup>b</sup>
	Residual	.000	3	.000		
	Total	.003	4			

- a. Dependent Variable: ROA
- b. Predictors: (Constant), Liquidity Ratio

Table 3: ANNOVA

Significant value will help us to determine the condition whether the same or significantly different from others Dutch Lady significant value were .012 which is less than 0.05.

Model Summary<sup>b</sup>

Model	R	R Square	Adjusted Square	R Std. Error of the Estimate	Durbin-Watson
1	.954 <sup>a</sup>	.910	.880	.0094419096 76146	2.931

- a. Predictors: (Constant), Liquidity Ratio
- b. Dependent Variable: ROA

Table 4 : Model Summary

In model summary, R square indicate the percentage of variation. Generally the higher the R square percentage, the better the goodness of fit. Based on the R square in table of model summary above, the percentage is 91.0% and it has been noted that R square is increased by 91.0%

Recommendation

In my opinion, Dutch Lady Malaysia should find a way to decrease their total liabilities (refer Appendix 2) because their total liabilities keep increasing. If Dutch Lady Malaysia does not decrease their liability, the probability to bankrupt will still exist even though Dutch Lady have a higer profit. This is because liability is obligation that a should meet. Dutch Lady can decrease

their liabilities and increase their capital by issue new equity. Equity investment is more secure because if a firm cannot meet the dividend payment, the company will not easily go bankrupt.

Next is that Dutch Lady Malaysia Should establish risk management committee (refer Appendix 2) in order to minimize any risk. Even though Dutch Lady Still perform well without risk management committee, but if there a good risk management committee maybe the profit will be boost up.

Other than that, Dutch Lady Malaysia should have a good Sharia Supervisory Board in order to increase volume of equity to be sold. This is because some investors only want to invest in Islamic Instrument.

Dutch Lady have a fixed actual meeting (refer Appendix 2) which were 4 times for a year. in my opinion, Dutch Lady can improve their performance by increasing their actual meeting. Maybe, this new strategy will help Dutch Lady to have a very good performance

Remuneration of BOD (refer Appendix 2) also should be increase because, its shows that the remuneration keep decreasing every year. plus, many other company provide a higher remuneration to their BOD.

## **5.0. Conclusion**

In conclusion, Dutch Lady have a good reputation in Malaysia. So that Dutch Lady need to protects their products to make sure a good image and increase people trustworthiness with Dutch Lady. Dutch Lady need to have a good solution if they facing controversies or problems. For example, Dutch Lady Malaysia have taken a calm solution by confronting the media and verified that Dutch Lady products does not contaminate.

Besides that, Dutch Lady should maintain their Corporate Social Responsibility in order to increase their image such as provide 'susu 1 Malaysia' for students in Primary School.

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