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CORPORATE GOVERNANCE MECHANISMS AND ACCRETIVE SHARE BUYBACK IN MALAYSIAN PUBLIC LISTED COMPANIES

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Abstract

Accretive share buyback is defined as an earnings management activity which is conducted to show an earnings surprise. It provides information for analysts and help in the decision making. The purpose of this study is to investigate the relationship between corporate governance mechanisms towards accretive share buyback among Malaysian public listed companies. The independent variables of this are corporate governance mechanisms which are, board size, CEO duality, multiple directorships and board independence while an accretive share buyback is the dependent variable. The sample consists of 100 companies listed in the Bursa Malaysia main market that announced their share buyback for the year 2016. Information on independent and dependent variables was obtained from the 2016 annual reports. Dependent variable used Hribar's model from Chandren, Zamri and Ruhani (2015) in order to measure accretive share buyback where the actual earnings per share (EPS) after share buyback (REPS) is expected to be more than a minimum of 1 cent against the pre-buyback EPS (PEPS). The result reveals that board size and board independence have a significant relationship with accretive share buyback while CEO duality and multiple directorships has no significant relationship with accretive share buyback. Therefore, the hypotheses for CEO duality and board independence towards accretive share buyback are not supported.

Keywords: Earnings management, corporate governance, accretive share buyback.

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1. Introduction

It is necessary for a company to disclose its earnings in its annual financial report. Information on earnings will help the investors, analysts, senior executives or board of director to get fair information for decision making (Degeorge, Patel & Zeckhauser, 1999). Companies prepare earnings report for three purposes, (Degeorge et. al., 1999), (1) to report the high amount of profit, (2) to show going concern performance of the company, at least make the last year earnings, (3) to meet the expectations of the stakeholders. According to Brown and Caylor (2005), the most prominent purpose is to meet the expectations of the shareholders. This can be met through achieving earnings surprises which will increase share prices, maximize the credibility of the management and to avoid legal action cost (Bartov, Givoly, & Hayn, 2002).

Usually, companies will be involved in two types of earnings management proxies which are accruals manipulation and real activities manipulation in order to make an adjustment in the financial reports. According to Hribar, Jenkins and Johnson (2006), companies use real activity manipulation, specifically, accretive share buyback as an earnings management proxy to achieve earnings surprise which may increase post-buyback earnings per share (EPS) by one cent minimum. In Malaysia, there is a corporate payout policy which allows the listed companies to repurchase the shares under the open market buyback program that is called the share buyback or share repurchased. According to Companies Act (2016), the solvent Malaysian public listed companies are only allowed to purchase their owned treasury shares with the approval of the shareholders when it should not exceed 10% of the issued and paid-up share capital through Bursa Malaysia.

Share repurchases occur due to activist shareholders, institutional investors, the government, and the media might put intense pressure for the companies to ensure their cash is being used for good purposes. Thus, after starting to do share repurchase or known as a share buyback, companies incur high cash flow that leads to greater shocking announcement returns (Almeida, Fos & Kronlund, 2016). In order for the companies to show a good performance on its financial report, earnings management activities help to attract more investors for the companies.

The existence of earnings management activity will show the weakness in corporate governance practices in the companies (Graham, Harvey & Rajgopal, 2005). Hence, in order to protect the shareholders' rights through this activity, the corporate governance best practices and principles act as an important symbol of a company. Corporate governance mechanisms, including board size, board independence, CEO duality and also multiple directorships will give a huge impact towards the company's performance and build a strong corporate governance which could be a strong tool to reduce earnings management activity in companies.

1.1. Board size.

According to MCCG 2007, the board must be in a sufficient size in order for them to be a high performing board (Securities Commission Malaysia, 2007). Nevertheless, MCCG 2017 does not specify the exact number of board size for every listed company (Securities Commission Malaysia, 2017). Thus, they have a right to set their own board size as long as it is able to manage the operation of the companies effectively. According to Jensen (1993), the growing boards will be less functioning on monitoring as they

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might be involved in bureaucratic problems, which could lead to conflict. However, Xie, Davidson and DaDalt (2003) stated that larger board will monitor financial reporting more effectively since the directors appointed by the company might have a knowledge and experiences. Meanwhile, if the size of the board is too small, it will reduce the ability to fulfil their function (Eisenberg, Sundgren & Wells, 1998). The lack of supervision from the board will provide a huge opportunity for the management to make an accretive share buyback, the earnings management activity.

1.2. CEO duality.

The MCCG 2017 stated that the positions of chairman and chief executive officer (CEO) are held by different individuals. Separation of the chairman and CEO position promotes accountability and facilitates the division of responsibilities between them thus no individual can influence board's discussions and decision-making (Securities Commission Malaysia, 2017). The board is said to be independent if the CEO and chairman positions are held by different individuals in one period (Bliss, Gul & Majid, 2011). Meanwhile, the occurrence of CEO duality can be assumed that if the CEO and chairman is the same person as well as there is no separation between the management and control decision. The responsibilities of a chairman are to hold board meetings and be involved in the appointment process of the senior management team. In addition, the CEO is subject to monitor the other executives and the effectiveness of the monitoring depends on the CEO power relative to the other executives (Tang, 2017) and the division should be clearly defined in the board charter as based in MCCG 2017 (Securities Commission Malaysia, 2017). On the other hand, when there is CEO duality, the power will be bound by only one person which may reduce the effectiveness of the corporate monitoring. In the meantime, MCCG seeks for transparency in providing information to the public in terms of the independence between the two positions, the CEO and the chairman, in order to promote the best governance practices (Chandren et al., 2015).

1.3. Multiple directorships.

Multiple directorships is when an individual who holds the directorship of more than one board at the same time (Haniffa & Hudaib, 2006). Based on Bursa Malaysia Listing Requirements (BMLR) in 2016, a director can hold up to 25 directorships at a one time, 10 for public listed companies and 15 for non-public listed companies. Hashim and Abdul Rahman (2011) stated that multiple directorships give a positive impact as the directors tend to be doing great in monitoring company's financial reporting quality, attain more skills and knowledge plus the expertise from other companies which enable them to verify the company's earnings management activity. Norman, Takiah and Mohd (2005) showed that multiple directorships can also reduce earnings management through accretive share buyback.

1.4. Board independence.

BMLR defined an independent director as a director who is independent of the management and free from any business or other relationship which could interfere with the exercise of independent judgment or the ability to act in the best interests of an applicant or listed issuer. MCCG 2017 stated that at least half of the board should be independent directors and for large companies, a majority of its members should be independent directors (Securities Commission Malaysia, 2017). Vo and Phan (2013) mentioned that outside

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members who can act as authorities in the centre during disagreements among internal managers must be included in the corporate board in order to be effective. A board's ability to be more efficient in monitoring its top management will be increased because independent directors bring high independence and objective judgment to the board and this mitigates risks arising from conflicts of interest or undue influence from interested parties. According to MCCG 2017, the tenure of an independent director does not exceed a cumulative term limit of nine years to maintain their independence and one-third of the board should consist of independent non-executive directors (Securities Commission Malaysia, 2017). In addition, the BMLR stipulated that at least two directors or one-third of the board, whichever is higher, must be independent.

1.5. Corporate governance mechanisms and accretive share buyback.

Share buyback has garnered the attention of researchers as a mechanism to manage earnings in their study (Farrell, Unlu, & Yu, 2014). The accretive share buyback is a form of earnings management activities that can increase the post-buyback EPS by a minimum of one cent (Chandren et. al., 2015). The study from Chandren et al. (2015), mentioned that if the company with large board size, it will encourage the company to involve in accretive share buyback. On the other hand, CEO duality has a positive relationship with accretive share buyback (Chandren et al., 2015). Besides that, multiple directorships have negative relationship towards accretive share buyback as if the directors have many directorships in another company, it will reduce the tendency of concernment in the current company, thus able to reduce company's earnings management through accretive share buyback (Chandren et al, 2015). In addition, the study also stated that if the company have greater board independence, the involvement in accretive buyback will also be greater.

2. Problem Statement

This study examines the relationship of corporate governance mechanisms which include board size, CEO duality, multiple directorships and board independence and accretive share buyback in Malaysian companies. In a previous study, Hribar et al. (2006) reported that companies used accretive share buyback (real activity manipulation) as the earnings management activity in order to show a good cash flow of the company. Nevertheless, real activity manipulation is difficult to detect as it can be assumed as similar to an ordinary business transaction in general. There are issues when some companies will consider share repurchase activity to manipulate their financial ratios to show the investors and market observers that their company is able to survive even though it is having a poor performance (Chandren et al., 2015). However, Chandren et al. (2015) stated that the strong corporate governance mechanisms can reduce earnings management activity in companies. There are considerable numbers of studies on corporate governance and earnings management, however, most of them focused on the performance or other tools of earnings management activities such as a study done by Vo and Phan (2013), Hashim and Abdul Rahman (2011), Graham et. al. (2005) and etc. Hence, there is lack of similar study conducted in Malaysia and the potential effects of the predictors on the accretive share buyback in Malaysian companies might also be different.

3. Research Questions

- Is there any relationship between board size and accretive share buyback among 100 Malaysian public listed companies?
- Is there any relationship between CEO duality and accretive share buyback among 100 Malaysian public listed companies?
- Is there any relationship between multiple directorships and accretive share buyback among 100 Malaysian public listed companies?
- Is there any relationship between board independence and accretive share buyback among 100 Malaysian public listed companies?

4. Purpose of the Study

Profits or earnings are the important part in the financial reporting that senior executives, board of directors, analyst and investors look for. Earnings management is the activity that does not contribute towards company value (Chandren et al., 2015). The needs of companies' good practices on corporate governance are to reduce the involvement of the management in earnings management activities. This will protect the interest of the shareholders and does not mislead them with the earnings management activities. All responsible people shall play their role in order to avoid from earnings management activities which may give a bad image to the company's reputation. The responsibility to introduce and practice the good corporate governance will control the earnings management activities as a whole. Nevertheless, there are limited stud about the effect of corporate governance mechanisms on the accretive share buyback in Malaysia. This study contributes to the understanding of the relationship between corporate governance mechanisms and accretive share buyback among public listed companies in Malaysia.

5. Research Methods

5.1. Sample selection.

The study examines the relationship between the corporate governance mechanisms and accretive share buyback among Malaysian public listed companies. The population consists of 191 companies listed in Bursa Malaysia main market that announced their share buyback for the year 2016. Hence, the study used simple random sampling and selected 100 sample companies based on the announcement of share buyback in Bursa Malaysia. The 2016 companies' annual reports were extracted from Bursa Malaysia website and companies' own website as they are the most recent sources of data available the time data was collected. The annual report was analysed to determine the elements of board size, CEO duality, multiple directorships and board independence, as well as the information of accretive share buyback.

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5.2. Data collection.

Table 01. Measurement of variables

Dependent Variable	**Definition**	**Measurement**	**Adopt from**
Accretive share buyback (ACCSBB)	Earnings management's activity that increases the EPS.	1 = Accretive share buyback 0 = Otherwise	Chandren et al. (2015)
Independent Variables	**Definition**	**Measurement**	**Adopt from**
Board Size (BDSIZE)	The total number of the directors on the board	The total number of directors on the board.	Chandren et al. (2015)
CEO Duality (CD)	CEO of the company is also the Chairman of the board of directors.	1 = CEO and Chairman is the same person 0 = Otherwise.	Chandren et al. (2015)
Multiple Directorships (MULTIDITR)	A person holding director position of more than one board.	The proportion of directors on the board of the company having at least one additional directorship in another company over the total number of directors on the board.	Chandren et al. (2015)
Board Independence (BDINDPDC)	The company must have a majority of outside or non-executive directors	The number of independent non-executive directors divided by the total number of board of directors.	Chandren et al. (2015)

From Table 01 above, the information on accretive share buyback, board independence, CEO duality, board size and multiple directorships are obtained from the annual reports. The reported EPS information for the year 2016 was collected from Thomson DataStream. In addition, dependent variable used Hribar's model from Chandren et al. (2015) in order to calculate the pre-buyback EPS on sample companies. For dependent variable, the accretive share buyback is estimated to this formula;

AEPS = REPS - PEPS

Where:

AEPS = Accretive Share Buyback

REPS = Reported EPS (annual report)

PEPS = *Pre-buyback EPS

*Pre-buyback EPS is compute as:

PEPS = Net income / (Outstanding shares + 0.5*Issued shares)

To identify whether the share buyback is an accretive, the actual EPS after share buyback (REPS) is expected to be more than a minimum of 1 cent against the pre-buyback EPS (PEPS). Thus, if there is accretive share buyback occur, it will be counted as "1", while "0" for vice versa (Chandren et al., 2015).

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5.3. Hypotheses development.

5.3.1. Board size:

According to Guest (2009), the impact of larger board size on profitability and share returns are strongly showed the relation of negativity. Large board size will cause problems such as poor communication between directors that will undermine the effectiveness of decision making (Bebeji, Mohammed, & Tanko, 2015). It also will cause a poor company performance due to less supervision from the board. Similarly, a study conducted by Yermack (1996) pointed out that compared to a large board size, small board size will oversight managers actively, that will mitigate accretive share buyback, the earnings management activity. Thus, the first hypothesis was developed;

H1: There is a relationship between board size and accretive share buyback among 100 Malaysian public listed companies.

5.3.2. CEO duality:

The position of a CEO and a chairman shall be held by different persons in order to avoid conflict of interests between them (Chandren et al., 2015). Katiuska and Josefa (2015) mentioned that no single person on the board shall be allowed to control other members in the decision-making process. CEO duality decreases the board monitoring effectiveness as it could create a conflict on the monitoring of the company (Chandren et al., 2015). Similarly, a study conducted by Norman et. al. (2005), found that there is a positive relationship between CEO duality and earnings management. The researchers suggested that there is in need to strengthen these elements in corporate governance and enforce the requirements to separate the CEO and the chairman. Furthermore, Johari, Saleh, Jaffar and Hasan (2008) found that CEO duality has no significant relationship towards discretional accruals. This is because lower CEO duality causes these variables to become insignificant. This helps to develop the next hypothesis;

H2: There is a relationship between CEO duality and accretive share buyback among 100 Malaysian public listed companies.

5.3.3. Multiple directorships:

Multiple directorships occurs when a person is holding a director position in more than one board. According to the Hashim and Abdul Rahman (2011), as the multiple directorships enable them to possess some knowledge, skill and experience which will lead diligent monitoring towards the management activity. Therefore, multiple directorships allows the discouragement towards the accretive share buyback as supported by Norman et. al. (2005). According to them, multiple directorships relationship towards the accretive share buyback is significant and it acts as an important monitoring mechanism. Thus, the next hypothesis was developed;

H3: There is a relationship between multiple directorships and accretive share buyback among 100 Malaysia public listed companies.

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5.3.4. Board independence:

Companies with more independent directors serving on the boards will maximize managements' behaviours and will distinguish between good and bad decisions made by management (Alves, 2014). According to Hashim and Devi (2008), there is no significant relationship existed between board independence and earnings management. However, a study by Huang, Wang, Lin and Huang (2010) stated that board independence affects the share repurchases. This is supported by Chandren et al. (2015) which found the presence of a positive relationship between board independence and accretive share buyback. The next hypothesis developed is as follows;

H4: There is a relationship between board independence and accretive share buyback among 100 Malaysian public listed companies.

6. Findings

6.1. Descriptive statistics.

Table 02. Descriptive statistics for board size, multiple directorships and board independence

	BDSIZE	MULTIDIR	BDINPDC
N	100	100	100
Minimum	4	.00	.25
Maximum	15	.83	.80
Mean	7.47	.4009	.4768

Based on Table 02, in terms of board size (BSIZE), the minimum number of directors on the board is 4 and the maximum number of directors is 15 persons. The average number of directors sit on a board is 7. The minimum percentage of multiple directorships (MULTIDIR) is 0 per cent and the maximum is 83 per cent. The average percentage of companies with multiple directorships is 40.09 per cent. This indicates that 40% of the companies have at least one member with additional directorship in another company on the main market. The minimum composition of board independence (BDINPDC) is 25 per cent and the maximum composition is 80 per cent. The average percentage is 47.68 per cent.

6.2. Table of frequency.

Table 03. Frequency table for CEO duality and accretive share buyback

		Frequency	Percent	Valid Percent	Cumulative Percent
CD	Yes	15	15.0	15.0	15.0
	No	85	85.0	85.0	85.0
	Total	100	100.0	100.0	
ACCSBB	Yes	90	90.0	90.0	90.0
	No	10	10.0	10.0	10.0
	Total	100	100.0	100.0	

Table 03 shows the frequency for CEO duality (CD) and accretive share buyback (ACCSBB). The result shows that a majority (85 per cent) of Malaysian public listed companies do not have CEO duality,

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while 15 per cent of Malaysian companies have CEO duality. In term of accretive share buyback (ACCSBB), 90 per cent of companies are involved with accretive share buyback which indicates that a majority of public listed companies in Malaysia is engaged with share buyback to increase their earnings per share.

6.3. Correlation analysis.

Table 04. Spearman's correlation analysis

		BDSIZE	CD	MULTIDIR	BDINPDC	ACCSBB
BDSIZE	Correlation coefficient	1.000	-.195	-.109	-.372	.531**
	Sig. (2-tailed)		.052	.279	.000	.000
CD	Correlation coefficient	-.195	1.000	-.033	.113	-.140
	Sig. (2-tailed)	.052		.744	.263	.165
MULTIDIR	Correlation coefficient	-.109	-.033	1.000	.244	-.079
	Sig. (2-tailed)	.279	.744		.015	.436
BDINPDC	Correlation coefficient	-.372**	.113	.244	1.000	-.315**
	Sig. (2-tailed)	.000	.263	.015		.001
ACCSBB	Correlation coefficient	.531**	-.140	-.079	-.315**	1.000
	Sig. (2-tailed)	.000	.165	.436	.001	

The first aim of this study is to examine the relationship between board size (BDSIZE) and accretive share buyback (ACCSBB) among 100 Malaysian public listed companies. Table 04 shows that the correlation of both variables is 0.53. This shows that there is a positive significant level at 0.01.Thus, there is a positive relationship between board size and accretive share buyback. Hence, hypothesis 1 is supported. This result is consistent with Chandren et al. (2015) which indicated a relationship between board size and accretive share buyback. Positive relationship implied that if there is larger board size, there will be higher accretive share buyback activity. This could be because a larger board size will provide less supervision to management and lead to an opportunity for management to do an accretive share buyback (Bebeji et al., 2015). Yermack (1996) found that if board size is larger there is more possibility for an earnings management activity will occur.

The second aim is to examine the relationship between CEO duality (CD) and accretive share buyback (ACCSBB) among 100 Malaysian public listed companies. The results indicate that there is no significant relationship between CD and ACCSBB. Thus, it can be concluded that the hypothesis 2 is not supported. The result contradicts the result of Chandren et al. (2015) where CEO duality has a positive impact on accretive share buyback. In this light, the lack of significant relationship might be because the separation between the CEO and chairman positions are unimportant as those holding those positions can be known as substantial shareholders (Alanezi, 2009).

The third focus is to examine the relationship between multiple directorships (MULTIDIR) and accretive share buyback (ACCSBB) among 100 Malaysian public listed companies. The results in Table 3 show that there is no significant relationship between MULTIDIR and ACCSBB. Therefore, hypothesis 3 is not supported. The result is not consistent with Chandren et al. (2015) which found a negative relationship between multiple directorships and accretive share buyback and a study from Hashim and Abdul Rahman (2011) which showed a positive significant relationship between multiple directorship and earnings management activity. In this regard, even though multiple directorships enables directors to possess more knowledge, skills and experience that help them to be more diligent in monitoring the management activity (Hashim & Abdul Rahman, 2011), however, the directors might not have the time to focus on such monitoring as they hold director positions in more than one board at the same time (Haniffa & Hudaib, 2006).

The fourth focus is to examine the relationship between board independence (BDINPDC) and accretive share buyback (ACCSBB) among 100 Malaysian public listed companies. The result implied that the BDINPDC and ACCSBB have a negative relationship. The correlation is -0.315, negative significant at the 0.01 level thus supported hypothesis 4. The result is consistent with Johari et. al. (2008) which stated that board independence has a negative relationship with earnings management despite the contradictory result with Chandren et al. (2015). Johari et. al. (2008) reported that high board independence results in greater board monitoring that reduces company's earnings management activities.

7. Conclusion

This study is conducted to identify the relationship between corporate governance mechanism and accretive share buyback in Malaysian public listed companies. It can be concluded that there is a relationship between board size and board independence with accretive share buyback in sample companies. Nevertheless, multiple directorships and CEO duality indicated no relationship with accretive share buyback.

As the board of directors plays an important role in monitoring management, MCCG 2017 stated that the board must set the appropriate tone at the top, providing thought leadership and championing good governance and ethical practices throughout the company. Besides, they are responsible to govern and set the strategic direction of the company while exercising oversight on management for the long-term success of a company and the delivery of sustainable value to its stakeholders. Directors are expected to exercise greater vigilance and professional scepticism in understanding and shaping the strategic direction of the company.

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