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# CORPORATE GOVERNANCE AND FIRM PERFORMANCE OF SHARIAH-COMPLIANT COMPANY OF CONSUMER PRODUCT INDUSTRY

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### *Abstract*

Previous literatures on the Corporate Social Responsibility (CSR) have been stressed on the roles of companies towards their stakeholders for being socially and ethically in business especially when involving in the matter of sustainability. This has reflected to the issue of the CG functions in influencing the way companies behave through business activities. The purpose of this paper is to examine the influence of corporate governance (CG) attributes towards firm performance of the Shariah-compliant companies, specifically on the consumer product industry. The results of the study revealed that the CG attributes failed to exude the significant links with firm performance, except for the board size. In the context of consumer product industry of Shariah-compliant companies, it is vital to impart its social responsibility through their business operations in relating to the production of products/services which ultimately could affect to the firm's financial health. Hence, the CG attributes play significant roles to ascertain that firm's bottom-line is sufficient to protect the stakeholders' welfares. Ways forward and limitation of the study are further deliberated.

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**Keywords:** Corporate governance, performance, Shariah-compliant, consumer product.

## 1. Introduction

The growing number of public listed companies with Shariah-compliant status (known as ‘Shariah-compliant companies’) underpinning the Islamic capital market is a reflection to the Islamic resurgence and increasing demand on the funds which offered by those companies whose business activities are carried out in accordance to the Shariah principles and are prohibited from engaging in activities that could shake the confidence especially among Muslim shareholders, such as *riba*’ (interest), *gharar* (uncertainty), *maysir* (gambling) and other speculation and unethical practices. Concerning that Shariah principles demonstrate the act of worship to God and sense of justice with other humans (Beekun, 1997), Islam solemnly puts a dividing line between Halal (permissible) and Haram (unlawful) practices in business activities which are closely linked to the ethical values and socially responsible in business. Opposition to the conventional idea of doing business which is only confined to succumbing to the commercial motive by Friedman (1970), the responsibility of companies nowadays is no longer hinges on solely making profit instead, but transcends to serving interests of wider circles of the stakeholders (Freeman, 1984) as a way to demonstrate social responsiveness through being ethical in business activities/practices (Carroll, 1979; Wood, 1991).

Since the protection of interests have widened to the corporate stakeholders, the consumer product industry constitutes as a significant sector that involves in producing food- and non-food products for its users, therefore the ways companies managing their resources are very crucial that determining the corporate bottom-line. Hence, the corporate governance attributes play essential roles to monitor the top management in managing well of their resources without neglecting the elements of quality and social values by ascertaining their trajectory and goals for the well-beings of their stakeholders, which are consistent with the values that are promoted in Islam. This is because from the lens of Islam, corporate governance attributes act as trustees of corporate resources, the persons who are entrusted to be responsible and have integrity to ensure that all resources are under the purview of top management that need to be well taken care of.

Given the importance of serving to the interests of consumers and other stakeholders in the context of the consumer product industry especially from the aspect of their nature of business and products would provide a substantial impact to the company’s performance. Since most of the performance-related studies are undertaken across industries, this study is expected to fill the loophole of the existing literature by focusing on single industry – consumer product industry, after taken consideration the nature of business of the studied industry which closely related to the rights of consumers in getting good product(s) producing by the responsible companies that can be considered from the aspect of its attributes such as halal status, hygienic and safe condition.

## 2. Problem Statement

Since the overall business operations of companies are under purview of their top management, therefore it is salient to have good governance to oversee the business activities are consistently operated in the manner that the conformance to the Shariah requirements are in place. Given that Shariah-compliant companies are the subset of the public-listed companies in which conventional capital market runs in parallel to the Islamic capital market, thus all legal and governance-related guidelines imposed by the

regulator are subject to be complied by the Shariah-compliant companies. Unlike the previous MCCGs which mainly provide concentration on the shareholders' interests, however the corporate governance reforms through the recent revised Malaysian Code on Corporate Governance (MCCG) 2017 has taken the stakeholders' interests into account which requires a balancing treatment from companies in conducting their business. This is because a proper governance allows fair distribution of responsibilities and rights of companies towards their direct and indirect participating parties. Thus, the good governance is expected to come up with better financial outcomes (Adjappong & Tauringana, 2015; Che Haat et al., 2008; Essen et al., 2012; Shawtari et al., 2017).

Islam emphasizes on the importance of holding responsibility and duties than on rights (Rice, 1999). Islam does not demarcate the lines between the practice of religion and business, since the elements of ethical values constitute a part of religion values and in fact it is proper guidelines for its adherents. Since the Shariah status is given for those listed companies that have been successfully meet the Securities Commission (SC)'s threshold in the screening process through the assessment of companies' business activities and financial activities, the companies are not only being ethically and religiously responsible in carrying out business, but they are also expected to have good performance in business to ensure the long-term growth and sustainability. This is consistent with concept in Islam that prevails more on the protection of humans' well-beings (i.e., welfare, interest or benefit) and to steer clear of any attempts that bring towards hardship or predicament (Arsad et al., 2015; Rahman, Tareq et al., 2017).

As far as the consumer products industry is concerned, this consumer industry is expected to be accountable in serving the needs of its wide range of stakeholders involving the food and non-food products, which entails for certain implementation of quality management system to ensure the production of quality products are in place (Fotopolous et al., 2010). However, the welfare of the stakeholders is often being neglected due to the emphasis given on the economic pursuits. Hence, being a religious-based business, this industry portrays the business activities of the companies must be undertaken as in accordance with Shariah principles and values which accentuate on the well-beings of its stakeholders through fulfilling their needs and desires, and stray from the path that incites any harm and hardship.

### **3. Research Questions**

1. How the CG attributes and performance of the Shariah-compliant companies under the consumer product industry?
2. Do the CG attributes influence the performance of the Shariah-compliant companies under the consumer product industry?

### **4. Purpose of the Study**

The objectives of the study are twofold; firstly, is to examine the corporate governance (CG) attributes and performance of the Shariah-compliant companies under the consumer product industry; and to investigate whether the CG attributes could influence towards the performance of the Shariah-compliant companies under the consumer product industry.

## 5. Research Methods

Followings are the deliberation on the research methodology pertaining to the nature of the research been carried out, data collection and the measurement of variables in order to meet the objectives of the study:

### 5.1. Research Design and Data Collection

The research design of this study is quantitative in nature, which employs a hand- collected method of data collection as it is an appropriate research technique that only involves in collecting or picking the related numerical figure(s) from the corporate annual report in order to achieve the objectives of the study. Given the population of the study is the Shariah-compliant companies with a total of 686 for a single year of 2017. As far as the single industry – sector of consumer product is concerned, thus the sampling procedures is undertaken by using purposive sampling method which mainly focusing on specific target or criteria that could provide the necessary information and fulfil the research needs (Sekaran and Bougie, 2016). It consequently has come up with a sample size of 101 companies of the consumer product industry. However, the original sample size has been reduced to 100 companies after considering a circumstance that requires to rule out the company that unable to meet the research procedure criteria due to the unavailability of the company’s annual report for the studied year.

Meanwhile, the data collection has been carried out through secondary data through hand-collected method from the corporate annual report in order to obtain the necessary figures and information that relating to the research variables. There are several segments of the annual reports that have been searched for and analysed for seeking the related corporate governance attributes (i.e., directors’ profile, CG statement) and financial performance (key statistics, financial statements).

### 5.2. Measurement of Variables

Pertaining to the data acquisition, Table 01 shows measurement of the studied variables which is quantitatively measured by made reference to the requirements of MCCG 2017 for the best practices among the public companies and the preceding CG-performance-related studies. This method of quantification has been extensively used by the prior studies on CG and performance which taken into account for the appropriate measurement of the CG and performance variables which are gathered from the most available and easily accessible document of corporate annual report.

**Table 01.** Operationalization of Variables

| Variables                     | Measurement of variables               |
|-------------------------------|--|
| <b>Dependent Variable:</b>    |  |
| <b>Financial Performance:</b> |  |
| Profitability                 | Profit before tax                      |
| Return on Asset (ROA)         | Net income after tax / $\sum$ assets   |
| Inventory Turnover            | Cost of goods sold / Average inventory |
| <b>Independent variables:</b> |  |
| <b>CG variables:</b>          |  |
| Board size                    | $\sum$ Number of directors on board    |

|                                       |   |
|---------------------------------------|---|
| Proportion of Non-Executive Directors | Percentage of Independent Non-Executive Directors (INEDs) to $\sum$ directors |
| Audit committee                       | Number of Audit committee on board  |
| Board meeting                         | Frequency of board meeting  |

## 6. Findings

### 6.1. Descriptive Analysis

**Table 02.** Descriptive statistics

|                    | Minimum      | Maximum     | Mean       |
|--------------------|--------------|-------------|------------|
| Board size         | 3            | 12          | 7          |
| INEDs              | 0.17         | 1           | 0.6        |
| Audit Committee    | 2            | 5           | 3          |
| Board meeting      | 4            | 14          | 5          |
| Profitability      | (72,811,000) | 956,862,000 | 48,357,669 |
| ROA                | -1.04        | 0.95        | 0.05       |
| Inventory turnover | 0.004        | 198.5       | 8.62       |

Based on the Table 2 above, it depicts that on average that companies of consumer product industry are in compliance with the recent revamp of the MCCG 2017, especially on the proportion of the INEDs which forms more than half as being recommended by the MCCG 2017 to achieve at least 50 percent of the boards comprises of independent directors. Whilst other independent variables (i.e. board size, audit committee and board meeting) which have not been stressed in the MCCG 2017 on the respective variable's structure and frequency, however, on average the companies the minimum requirements of CG in a way to strengthen the abilities of the board in carrying out their fiduciary responsibilities.

### 6.2. Inferential Analysis

Correlation analysis

**Table 03.** Correlation Coefficient

|                 | Profitability   | Return on Asset  | Inventory turnover |
|-----------------|-----------------|------------------|--------------------|
| Board size      | 0.00** (0.421)  | 0.002** (0.290)  | 0.058 (0.158)      |
| INEDs           | 0.051 (-0.165)  | 0.009** (-0.237) | 0.464 (-0.009)     |
| Audit committee | 0.313 (0.049)   | 0.287 (0.057)    | 0.332 (0.044)      |
| Board meeting   | 0.008**(-0.241) | 0.003** (-0.271) | 0.139 (-0.109)     |

Note: \*\* Correlation is significant at the 0.01 level (1-tailed)

\*\*\* Correlation is significant at the 0.05 level (1-tailed)

The table 3 above depicts the correlation results between the tested variables after the normality test has been taken into consideration with the significant results have been produced, and the findings find that there are significant relationships between the CG variables and performance. For instance, board size is found has positive association with the respective profitability and return on asset. In other words, the higher

number of directors on the board plays significant roles in the financial performance's variables, but no significant relationship with the inventory turnover. Meanwhile, the proportion of INEDs has significantly associated with the companies' return on asset, however no significant findings are found in other performance variables. Nonetheless, audit committee has no significant relationship at all with the performance's variables. The frequency of board meetings that companies' held is essential to beef up the firm's performance when it is found that it has significantly negatively associated with profitability and return on asset. These findings are consistent with the prior studies which have produced similar result of findings on the association between CG attributes and financial performance.

## 7. Conclusion

The roles of business in the midst of society are essential to craft reciprocal functions and benefits between the firm and its wider circles of stakeholders. Reminiscing to the seminal idea of the firm's existence, the motives of the business operators weigh more on delineating costs reduction and improvement in profit which are derived from the factors of production. However, from the lens of Islamic approach, the business organisations act as being socially responsible to the society through its business activities. In the context of consumer product industry of Shariah-compliant companies, it is vital to impart its social responsibility through their business operations in relating to the production of products/services which ultimately could affect to the firm's financial health. Hence, the CG attributes play significant roles to ascertain that firm's bottom-line is sufficient to protect the stakeholders' welfares.

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