CEO DUALITY AND FIRM PERFORMANCE: A CASE STUDY OF TENAGA NASIONAL BHD, TELEKOM MALAYSIA BHD AND YTL POWER INTERNATIONAL BHD.

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ABSTRACT

There have been many researches on the impact of CEO duality on firm performance done in the UK and USA. Where Malaysian companies are concerned, there have been limited studies. The purpose of this paper is to review the literature on the topic and to compare their findings with three Malaysian companies. Previous research findings have been varied as some found that duality enhanced the firms' performance, while others did not find significant difference in performance among firms adopting duality and separate structure. This study used the data of three listed companies, two of which have similar background, being monopolies in their industries and government owned, regulated, supported and protected, while the other company is owned by individuals, successful and a leader in its industry. Our findings showed that Tenaga Nasional Berhad perform better after it changed to separate board structure, while YTL performed well under duality.

1.0 INTRODUCTION

The shareholders of public companies have the power to decide its board of directors structure. In other words, the board of directors are the selected people entrusted to lead and act on behalf of its shareholders and protect their interest. Moreover, there are two leadership structures that are either to have an independent board leadership or chief executive officer (CEO) duality. The former means having two different persons as chairman and chief executive director while the latter is having one person holding both posts, hence duality (Boyd 1995, Dalton and Daily 1998 and Rechner and Dalton 1991). Daily and Johnson (1997) suggested that CEOs "set the tone for the entire corporation". A CEO is indeed a very important person in a company.

According to Sinha (1999), firms with CEO duality usually have significantly smaller board size, a lower proportion of non-executive directors and institutional shareholdings. She said however, boards with CEO duality have significantly larger directors block shareholdings, the CEOs are older and they have a longer tenure and the firms are bigger. They also have higher returns on capital employed.

Some believe that dual leadership structures would trigger conflict of interest and reduces the board's ability to fulfil its governance function. Duality has been blamed for poor performance and slow response in firms such as General Motors, Goodyear Tire and Rubber and Digital Equipment (Boyd 1995).

The objective of this study is to compare the findings of previous studies to the performance of the three selected companies and to discuss the similarities and /or differences.

TEORY OF DUALITY

Boyd (1995) stated that an agency problem exists when an agent (CEO) has established goals which conflict with that of a principal (shareholders). Such problems are more likely (Boyd 1995, Dalton and Daily 1998 and Rechner and Dalton 1991). Daily and Johnson (1997) suggested that CEOs "set the tone for the entire corporation". A CEO is indeed a very important person in a company.

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2.0 LITERATURE REVIEW

Boyd (1995) stated that an agency problem exists when an agent (CEO) has established goals which conflict with that of a principal (shareholders). Such problems are more likely to occur when a key decision-maker has little or no financial interest in the outcome of his decisions. Such senior executives are more likely to pursue strategies which:

a) maximize personal welfare at the expense of shareholders.
b) minimize their personal risk.

Agency problems and the failure of the board to fulfil its control responsibilities effectively has been linked with numerous adverse outcomes, including higher levels of executive compensation, awarding golden parachutes, adoption of 'poison pills', payment of greenmail and wealth-diluting acquisition. This agency theory would propose that combination of CEO and chairman positions would weaken board control and negatively affect firms' performance (Boyd, 1995).

Boyd (1995) addresses limitations of agency theory as applied to CEO duality and examines several perspectives, which, can be integrated under the umbrella of stewardship theory. An implicit assumption of the agency model is that executives are inherently opportunistic agents who will capitalize on every chance to maximize personal welfare at the expense of shareholders.

Donaldson (Boyd, 1995) voiced concern with the failure of agency theorists to address and integrate related research in organizational behaviour and organizational theory. The desire to maximize income, for example, might be counterbalanced by a much larger range of human motives, including needs for achievement, responsibility, and recognition as well as altruism, belief, respect for authority and the intrinsic motivation of an inherently satisfying task. Thus, the CEO far from being an opportunistic shirker essentially wants to do a good job, to be a good steward of the corporate assets. Therefore stewardship theory would propose that CEO duality would facilitate effective action by the CEO and consequently lead to higher performance.

Daily and Johnson (1997) said that the centralization of power achieved under the dual board leadership structure has many concerns. They stated that the primary concern is that the dual structure provides the potential for managerial domination of the board of directors. The dual structure enables the CEO to control the agenda of board meetings, determine what information directors receive in advance of meetings, and lead board-meeting discussions. As a result, when the CEO formally dominates the board as chairperson, effective board control of management may be less likely. With the absent of effective oversight, management is more able to pursue interests, which do not best serve the shareholders.

Rechner and Dalton (1991) examined the differential financial implication (firms performance) on the two different leadership structures that is, CEO duality and independent board leadership. Their samples were composed of a randomly selected 250 of the Fortune 500, the data which are relied on for the six-year period (1978-1983).

They utilised return on equity (ROE), return on investment (ROI) and profit margin as performance indicator. Their results showed that firms with independent governance had consistently outperformed the CEO duality firms, although they were no difference in ROI, ROE and performance margin between those two different structures.

Accounting return is one of the indicators for the firm performance. Recent work by Rechner and Dalton (1991) used two dimensions of financial performance (its level and risk) as performance indicators. This study suggested that CEO duality structures do result in lower returns, but there may be less variance in those returns as some function of the increased coordination and operational efficiency which is arguably attendant on such structure.

Baliga, Moyer and Rao (1996) studied a linkage between duality and firm performance. Their research considers a comprehensive set of performance measures including announcement effect of duality status changes,variations in accounting measures of performance around duality status changes and the impact of duality on a long term market-oriented measure of performance i.e market value added (MVA).

They found that there was no evidence that changes from duality to non-duality or from non-duality to duality have any measurable impact on the operating performance of the firms. Further, they found that there was no difference in performance between firms with total non-duality during the period of study, and firms with total also suggested that there was no evidence of significant announcement effects associated with changes in a firm's duality status.

A study by Daily and Dalton (1993), on the board of directors leadership and structure: control and performance implications found that the incidence of CEO duality will be higher for those companies whose CEO is the founder of the firm. However, they failed to find any relationship between duality status and firm performance.

Baliga *et al.* (1996) stated that CEO supporting this position contend that non-duality would:

a) dilute their power to provide effective leadership of the company by increasing the probability that actions and expectations of management and the boards are at odds with each other;
b) create the potential for rivalry between the chairperson and the CEO;
c) create confusion as a result of the existence of two public spokesmen; the chairperson and the CEO;
d) limit innovation and will intrapreneurship if the CEO feels that the board will perennially second his or her actions.

However, Carver (Baliga *et.al,*1996), said that opponents of duality will maintain that duality:
a) constraints board independence and reduces the possibility that the board can properly execute its oversight and governance role;
b) signals the absence of separation of decision management and decision control;
c) makes it difficult for insecure directors to be honest when evaluating firm performance, which in turn, leads to long-term organizational drift.

A recent study in Malaysia by Rashidah and Roszaini (2002) investigated the extent of CEO duality on performance for all non-financial and non-trust companies listed on the main board of Kuala Lumpur Stock Exchange. Their findings indicate that companies with role duality seemed not to perform as well as their counterparts with separate board leadership based on accounting performance measurements.

3.0 DATA PRESENTATION

3.1 The companies

The companies selected are Telekom Malaysia Bhd. (Telekom), Tenaga Nasional Bhd. (TNB) and YTL Power International Bhd. (YTL). These companies were selected as they provide similar services. TNB and YTL are major electricity providers for the country, while Telekom monopolises fixed line telephone services in Malaysia as well as being a major provider of telecommunication in the country. Below is brief information regarding each company.

3.1.1 Telekom Malaysia Bhd

Telekom was incorporated to takeover the operations of Jabatan Telekom Malaysia as part of the government's privatization exercise. The company was listed on the main board of the Kuala Lumpur Stock Exchange (KLSE) on November 7, 1980. It has a paid-up capital of RM3,162,349, 380 (par value of RM1.00 each) and is classified as trading services.

4.0 DISCUSSION

Daily and Johnson (1997) stated that both academic literature and the popular press provide accounts of the widely shared belief that the CEO is the most powerful organizational member in the modern corporation. Daily and Dalton (1993) said that the reason that positions of chairman and CEO are usually combined is that, this provides a single focal point for company leadership. There will never be any question about who is boss or who is responsible.

Sinha (1999) mentioned that, firms with CEO duality usually have significantly smaller board size, a lower proportion of non-executive directors and institutional shareholdings. On the other hand, boards with CEO duality have significantly larger directors block shareholdings, the CEOs are older and they have a longer tenure and firms are bigger. The firms also have higher returns on capital employed.

Our observation is that YTL had bigger board size (14 people or more) as compared to TNB (between 12 and 14) and Telekom (11 people) for the entire five years. Telekom has 10 non-executive directors (TNB had 11) and one executive director (TNB had one before 1st September 1999 and two after the date). YTL on the other hand did not specify whether or not its directors were non-executives and had a chairman cum CEO throughout the period of observation.

YTL's current chairman (and CEO) has been in office since the date of incorporation as a private company (October 18th 1996). Telekom's chairman (Dato' Ir Md Radzi bin Hj Mansor) has been in office since 1999 replacing its previous chairman Dato Ali bin Hassan. Its CEO (Dr Md Khir bin Abdul Rahman) started his service since year 2000. Ever since having separate board structure, TNB has had the same chairman (Dato' Dr Jamaluddin bin Dato' Mohd Jarjis) and two CEO (Dato' Fuad bin Jaafar and currently Pian bin Sukro). This is true as Sinha's observation that board with duality has longer tenure and older CEO (YTL's Tan Sri Dato' Seri (Dr) Yeoh Tiong Lay is 72 years old). Where firm size is concerned, YTL has a paid-up capital of RM2,228,671,843 (par value RM1.00), while both TNB and Telekom has bigger capital (RM3,107,845,301 and RM3,162,349,380 respectively). When comparing ROCE, YTL had higher return (1998: 8.35%, 1999: 12.06% and 200: 6.59%) as compared to TNB and Telekom. This is also as Sinha's findings that firms with duality has higher returns on capital employed.

The government of Malaysia is the substantial shareholder TNB and Telekom having more than 70% interest from various agencies while YTL has about 4% government holding. Institutional shareholding make-up 47% and 75% in TNB and Telekom respectively, however YTL has 80%. Directors'shareholding in TNB and Telekom is insignificant (far less than 1%) and YTL only 0.2%. However, YTL directors have substantial interest in other subsidiaries and associate of YTL Power Group making its chairman as its substantial shareholders (62%)

A study by Daily and Dalton (1993) found that the incidence of CEO duality will be higher for those companies whose CEO is the founder of the firm. A contingency analysis provides strong support for the proposition that founder-managed firms will be associated with higher incidence of CEO duality. Our observation agrees to Daily and Dalton (1993) as YTL has these characteristics as being founder-managed firm unlike TNB and Telekom.

Referring to Stoeberl and Sherony (Baliga it.al, 1996), proponents of duality argue that duality should lead to superior firm performance as it permits clear-cut leadership for purposes of strategy formulation and implementation. In our observation, TNB was not performing well when practising duality (1997,1998) however, its performance improved after having separate board, but YTL and Telekom had been in a more fluctuating performance.

5.0 CONCLUSION

Agency Theory suggests that CEO duality would weaken board control and resulting to poor performance of the firm. Meanwhile, Stewardship Theory suggests that duality will lead to higher performance since it facilitates effective control by the CEO.

In the case of TNB, the firm performed better after it change to a separate board structure as compared to when practicing duality, as agency theory suggested (but not Stewardship theory). However, YTL performed well under duality (like suggested by stewardship theory). These two companies contradict each other. However, Baliga et al. (1996) found that there is no evidence that changes from duality to non-duality or from non-duality to duality have any measurable impact on the operating performance of the firms. Further, they found that there is no difference in performance between firms with total non-duality during the period of study, and firms with total duality. TNB did not perform well during the years 1997 and 1998 while both YTL and Telekom perform well.

Boyd, (1995) stated that the current trend in corporate governance separates the positions of Chairman and CEO. He also found that duality had weak and statistically insignificant, correlation with performance. Separation of CEO and Chairman to please shareholders and institutional may prove dysfunctional in the long term. Daily and Johnson (1997) found that CEO duality was neither significantly affected by firm performance nor did it significantly affect form performance positively or negatively.

Some research found that duality will enhance the performance of the firms but most of the research done did not find any significant difference in performance between firms adopting duality structure and firms with independent structure. The mixed results might be due to the different performance indicator used by the researchers.

Apart from the different performance measurement, other important influences on performance such as political influence, business experience and entrepreneurship might be omitted from those studies. This can be observed in TNB and Telekom as these two companies remain a government owned hence regulated, supported and protected, a monopoly, while YTL started as a family business and eventually a listed company with a different entrepreneurs characteristics.

A similar and extensive research (see Rashidah and Roszaini, 2002) of Malaysian companies found that companies with role duality seemed not to perform as well as their counterparts with separate board leadership based on accounting performance measurements. Therefore, based on these three companies, we agree that companies with separate board structure perform better than companies with duality.

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