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BOARD EFFECTIVENESS AND COMPANY PERFORMANCE: ASSESSING THE MEDIATING ROLE OF CAPITAL STRUCTURE DECISIONS

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ABSTRACT

This study examines the mediation effect of capital structure decisions on the relationship between board process and company performance in Malaysia. The study uses two types of data; a questionnaire survey of Malaysian directors and the companies' annual report. Based on 175 public listed companies, the study finds that effective independent directors and boards who monitor company risks vigorously are more likely to monitor management from adopting excessive leverage, which results in positive company performance. Overall findings are expected to serve as a basis for more effective corporate governance policies and practices in Malaysia in ensuring the sustainability of the listed companies.

Keywords: Board Process, Capital Structure, Company Performance, Independent Directors, Risk Oversight

1. INTRODUCTION

The board of directors is one of the prominent corporate governance mechanisms as they are expected to monitor and protect the interests of shareholders. Even though previous corporate governance literatures recognize the importance of board of directors (Kula, 2005; Wan & Ong, 2005), the studies on the directors' behavior and practices in conducting their roles are still lacking (Hasnah & Hasnah, 2009). Most of previous studies focus on the direct effect of board structure, composition and characteristics on company performance or leverage (Noriza, 2010; Rohana, Halimi & Erlane, 2009; Yu, Rwegasira & Bilderbeek, 2002). Such board attributes alone does not reflect the quality of the board, therefore, study on board process is highly demanded. Board process refers to the approach taken by the directors in discharging their duties and the reflection of board's decision making activities (Macus, 2008). From the

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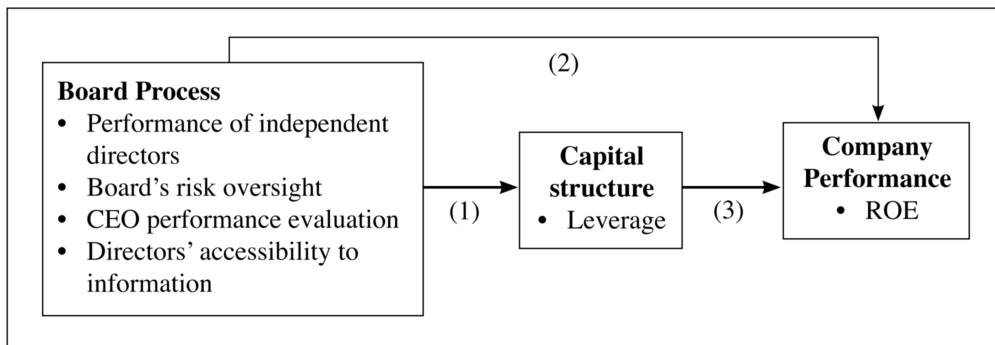
theoretical perspectives, the board monitoring function is very important; it is derived from agency theory (Jensen & Meckling, 1976). As decision making falls to top management, the board should vigorously monitor the decision making process and company performance as a whole (Jensen & Meckling, 1976).

Johnson, Daily and Ellstrand (1996) point out that board process influences company performance through strategic decisions. Decision on capital structure is the essential part of strategies implementation (David, 2008). The cases of Lehman Brothers and Bear Stearns in the United States and Linear Corporation Berhad in Malaysia have shown the evidences that highly leverage capital structure lead to company failure. Therefore, as proposed by Johnson et al. (1996) and David (2008) this study will incorporate leverage as mediator variable. The proposal is also similar to the recommendation by La Rocca (2007) where the author points out that board effectiveness, capital structure and company value should be incorporated in a study. Based on above arguments, the main objective of this study is to determine the extent to which capital structure decision mediates the relationship between board process and company performance.

In this study, four prominent attributes represent the board process namely board's risk oversight, Chief Executive Officer (CEO) performance evaluation, performance of independent directors and directors' accessibility to information. In analyzing whether company leverage mediates the relationship between board process and company performance, the study takes into consideration three conditions (Baron & Kenny, 1986). The study presumes a significant direct relationship between (1) board process and capital structure decision and (2) board process and company performance. Then in the third (3) step, capital structure decision is treated as the intervening variable between board process and company performance. Figure 1 illustrates the relationship between board process, capital structure decision and company performance.

Figure 1: Board Process, Capital Structure Decisions and Company Performance



The paper is organized as follows. In the following section, the predictions on the influence of board process on capital structure decisions and company performance are presented. The third section presents the research methodology followed by the research findings in the fourth section. Finally, the discussion and conclusion of the study is presented in the last section.

2. LITERATURE REVIEW

2.1. Board process attributes

2.1.1 Board's risk oversight

A business risk relates to the inability of a company to predict the future performance in an uncertain environment (Sobel & Reding, 2004). Therefore, the board roles in risk management are very important so as to ensure that the company will survive in uncertain economic conditions (Raber, 2003). The board is responsible to monitor the management decisions by asking them the possible risks that a company may be facing (Raber, 2003). Besides, board is responsible for determining the company's risk tolerance (Malaysian Code of Corporate Governance (MCCG), 2012) so as to guide senior management in making decisions. These practices in turn enhance the risk culture among the board members. By having an effective risk oversight, the decision making process by the management will always be monitored. With regards to company capital structure, such board attitudes are able to influence the management to take non-excessive leverage. Besides, Dulewicz and Herbert (2004) discover that a board that evaluates current and future internal and external corporate risks has a positive impact on company performance. Boards that give less emphasizes on risk management can lead to company failure (Murphy & Brown, 2009). Therefore, this study expects a positive impact of board's risk oversight on company leverage and performance.

2.1.2 CEO performance evaluation

CEO performance evaluation refers to the measurement and procedures that are established by the board to evaluate the CEO. The evaluation process enables the board to keep track and provide suggestions about a CEO performance (Robbins & Judge, 2009). This has positive consequences for companies as the CEOs become aware that they are being closely monitored and assessed by the board (Dulewicz & Herbert, 1999; 2004). The MCCG (Revised 2007) and MCCG (2012) recommend that the effectiveness and contributions of every director on the board, including the CEO, need to be assessed. Therefore, the CEOs need to pay extra attention to the decision making process as their performance will be accessed based on the outcomes of their decisions. In relation to capital structure, the CEOs prefer to avoid high risk decisions in order to mitigate the company from getting financial difficulties. In addition, the reflection of CEO performance can be seen in company profitability. Kula and Tatoglu (2006) and Kula (2005) find out that an effective performance evaluation contributes to positive company performance. Hence, the evaluation towards CEO performance by the board is expected to have effect on company performance.

2.1.3 Performance of independent directors

Independent directors are expected to monitor independently the management work and decisions (Shamsher & Zulkarnain, 2011). Effective independent directors with broad skill sets and experience are capable of providing checks and balance in boardroom deliberations (Finkelstein and Mooney, 2003). In addition, independent directors who provide constructive questions to the management will cause the managers to be more prudent before they make

decisions (McCabe & Nowak, 2008). The MCCG (Revised, 2007), MCCG (2012) and Bursa Malaysia Listing Requirements emphasize the importance of independent directors. In relation to board effectiveness, the board must consist of at least one-third of independent non-executive directors in order to ensure that these directors can provide independent judgment. Prior to the appointment, a few characteristics need to be evaluated namely their skills, knowledge, professionalism, experience, integrity and expertise. Effective and competent independent directors dissuade management from excessive risk taking to protect the shareholders and the company. Besides, Hasnah and Hasnah (2009) provide evidence that those independent directors who are able to provide unbiased views contribute to positive company performance.

2.1.4 Directors' accessibility to information

Directors must ensure that they receive adequate and meaningful materials prior to the board meetings so as to have adequate preparation (Finkelstein & Mooney, 2003) and improve their problem solving ability during board deliberations (Macus, 2008). Besides, directors with sufficient information are able to provide constructive arguments to top management (Zahra & Pearce, 1989) and enhance their accountability towards shareholders (Kula, 2005). Unable to do so, the directors will not have sufficient time to understand the issues, which will lead them to agree with the decisions of the CEO without voicing out any arguments (Finkelstein and Mooney, 2003), even when company decisions are against shareholders' interests namely, adopting excessive leverage. Further, Kula and Tatoglu (2006) assert that accessibility of information is the key component to improve company performance. Hasnah and Hasnah (2009) also find a positive association between accessibility of information and company performance. Therefore, boards that get sufficient access to company information are expected to have positive impact on company leverage and performance.

2.2. Control variables

Three control variables were included in this study: company size, age and sector. These control variables were chosen based on previous literature as factors that may be associated with the company leverage and performance.

Kyereboah-Coleman (2007) provides evidence that a large company is more likely to employ high leverage and most companies are in favor of long-term borrowings. Larger companies are more diversified and able to increase their cash flow than smaller companies (Morri & Cristanziani, 2009). Consequently, these companies have the capability to service their loans and thus face lower risks of bankruptcy. With regards to company performance, larger companies can increase investors' confidence in safeguarding investors' interests (Tam & Tan, 2007) and establish various diversifications in business (Kyereboah-Coleman, 2007). Large companies are able to maintain stable cash flow and less likely to be affected by changes in the market environment (Fu, Ke & Huang, 2002). Furthermore, such companies have easy access to capital markets and this lead to lower bankruptcy risk (Feidakis & Rovolis, 2007). The characteristics and advantages of large companies lead to better performance.

Kyereboah-Coleman (2007) finds that company age is positively associated with company leverage. Mature companies that have established themselves in the market find it easy to

obtain external financing since these companies have a good reputation. In relation to company performance, Noor Afza (2011a) indicates a negative association between company age and company performance. The rationale behind the finding is that older companies tend to become more conservative in strategy, thereby reducing company performance. Company sector appears to be a primary determinant of capital structure because companies in similar industries tend to have similar needs in financing.

2.3. Board process mediates the relationship between the capital structure decisions and company performance

Board process is expected to improve company performance through its effect on company leverage. The 1997/1998 crisis shows that excessive leverage leads to company failure (Fong, 2008). Datuk Megat Najmuddin Khas argued that Malaysian directors particularly the non-executive directors did not carry out their duties diligently before the crisis (Thomas, 2002). The evidence seems to suggest that if the board does not mitigate the risks of having excessive leverage, the company is more likely to suffer (Murphy & Brown, 2009). Increases in leverage, in turn, lead to lower returns to shareholders. Companies with high dependency on debt financing have to pay fixed borrowing costs even if the business condition is not in their favor (Keown, Martin, Petty & Scott, 2008). In addition, commercial banks tend to charge those companies a higher interest rate because the possibility of defaulting on borrowings is higher. The situation reduces the company's earning significantly and affects company performance as a whole. This helps in understanding that company performance suffers by having ineffective board members (Johnson et al., 1996) who are not able to encourage less risky capital structure decisions.

Thus, when directors perform their roles effectively, particularly their monitoring and services roles, they are expected to influence management to invest in a less risky capital structure (Mande, Park & Son, 2012). The effectiveness of the board in influencing the capital structure decision will influence company performance. The study suggests that it is crucial to empirically examine leverage as a potential mediator. The mediating variables help to explain the relationship between board process and company performance.

3. RESEARCH METHODOLOGY

3.1. Construction of questionnaire

This paper aims to determine the company leverage effects on the relationship between board process and company performance. The study uses two types of data which are questionnaire survey of Malaysian directors and the companies' annual reports. Data on company characteristics and performance are extracted from the annual report of 2007 to 2009. With regards to board process, a draft of the questionnaire was developed based on previous literature. Input from three representatives of two regulatory bodies and three directors of public listed companies enhanced the questionnaire content. The three representatives from a regulatory body included two specialists who are attached to the risk management department and frequently deal with CEOs and board members. They provided valuable input on how

directors should monitor their management, particularly with respect to risk management. In addition, an executive chairman of a committee from a different regulatory body provided a range of perspectives on the role of directors. He emphasized the importance of the board and senior management in managing risks. Information provided by the three directors from three different well-known companies provided a better picture of board practices.

Based on the interviews and past literature, an early draft of questionnaire was developed. Then, the draft was distributed to four directors and three senior academicians who have vast experience in survey studies. The preliminary study was conducted in order to clarify the items and ensure the relevancy of the items in the questionnaire. Based on their feedbacks, the questionnaire was corrected and amended. This was followed by a pilot study which was conducted within two months and involved 30 boards. The duration of pilot study and number of respondents proves that dealing with company directors is a demanding task. Once the pilot test had been completed, the questionnaire was amended and a comprehensive questionnaire was then developed. Then, a full survey was carried out. The complete questionnaire has three parts; first part consists of 31 items on board process, the second part consists of five factual questions of board practices and the last part consists of six demographics items.

3.2. Sample size and data collection

The Malaysian company is chosen as the unit of analysis. The respondents are board of directors of Malaysian companies listed on the main board of Bursa Malaysia. Studies that involve top executives always receive a low response rate, usually less than 25% (Westphal, 1999). In Malaysia, the response rate for survey studies ranges from 10% to 20% (Hasnah & Hasnah, 2009). Therefore, the researcher believed that every public listed company should be included to increase the number of responses. This approach was similar to Wan and Ong (2005) that included the whole population of Singapore public listed companies as the sample. Wan and Ong's (2005) study is intended to assess the link between board effectiveness and company performance. There were 686 companies listed on the main board for the year 2009 (after excluding companies which are listed under financial sector, new companies that are listed in 2007, 2008 and 2009 as well as PN17 and Ammended PN17 companies).

The questionnaires were sent through mail to different directors (company chairman, independent director, non-independent non-executive director and executive director) via company secretary. The researcher intends to get response with balanced perspective. A support letter from Malaysian Institute of Chartered Secretaries and Administrators (MAICSA) is enclosed in order to obtain more participation from company secretary. The questionnaire with cover letter to company secretary and directors and self-addressed, stamped-return envelopes were placed in every envelope to company secretary. Once responses from the questionnaire were obtained, they were matched against secondary data for the particular company.

3.3. Measurements

There are three sets of variables which are board process, company performance and characteristics. Return on equity (ROE) represents the company performance measurement. The ratio is determined by dividing net profit to the average shareholders equity. Even though

there is no consensus on the best measurement of financial performance, the most important point is that the result can reflect the shareholders' and accounting return (Cochran & Wood, 1984).

In relation to board process, this study utilizes four process variables adapted by Kula (2005). The variables are board's risk oversight, CEO performance evaluation, performance of independent directors and directors' accessibility to information. In relation to board's risk oversight, "board communicates on risk tolerance to senior management" was taken from Sobel and Reding (2004). As suggested by Raber (2003), three statements were included: "board raises concerns about risk management", "board receives updates from senior management on risk management matters", and "board requires senior management to deliberate on emerging risks that the senior management perceives the company will face". Meanwhile, "members of board encourage senior management to use scenario analysis in identifying potential vulnerabilities" was taken from Finkelstein and Mooney (2003). In addition, "board has necessary financial knowledge to analyze financial statements" was adopted from Murphy and Brown (2009) and "board reviews its strategy during crisis" was taken from Carey, Patsalox-Fox, and Useem (2009). Furthermore, as suggested by Wyman (2009), the statement "board attends relevant risk management training" was included. In measuring the board's ability on risk oversight, five-point Likert scale was used: strongly disagree = 1, disagree = 2, neutral = 3, agree = 4 and strongly agree = 5. Higher scores indicate higher ability of board on risk oversight.

In relation to CEO performance evaluation, eight statements were designed to represent the construct. One statement was adopted from Kula (2005): "board evaluates CEO by using key performance indicator (KPI)". "Board accepts feedback from CEO during the process of setting KPI" and "board provides avenue for CEO to explain the state of CEO's performance" were taken from Taylor, Tracy, Renard, Harrison, and Carroll (1995). A statement from Epstein and Roy (2005) was also included: "board communicates their expectations clearly to the CEO". Furthermore, one statement was adopted from Wyman (2009), "board implements a reward system based on long-term performance". Meanwhile, "board establishes an exit mechanism tied to CEO's performance" was taken from Finkelstein and Mooney (2003). Two other statements were adopted from Dulewicz and Herbert (1999; 2004): "board communicates to the CEO on his/her success based on the evaluation result" and "board communicates to the CEO on his/her failures based on the evaluation result". The statements were measured by using a five-point Likert scale similar to Kula (2005): strongly disagree = 1 to strongly agree = 5. Higher scores represent high effectiveness of board in evaluating CEO's performance.

Meanwhile, ten statements were adopted from Ingley and Van der Walt (2005) to represent the performance of independent directors. These statements include, for example, "Quality of independent directors' contribution in board committees" and "Independent directors' understanding of company business". The statements were measured using a Likert-scale ranging from very poor = 1 to outstanding = 5. Higher scores indicate higher level of independent directors' performance. In measuring the directors' accessibility to information, five statements and five-point scales (strongly disagree = 1 to strongly agree = 5) is used. Four statements were adapted from Sang-Woo and Il (2004) and MCCG (Revised, 2007):

"directors have access to information via management", "when directors need to refer to company business records and books of accounts, their access is denied", "when outside professional services are needed, the expenses will be borne by the company", and "directors receive sufficient materials/information before board meetings". Meanwhile, the statement "directors discuss issues thoroughly with management" was adapted from Ingley and Van der Walt (2005). Higher score indicates good access of information by the directors.

This study includes three control variables; company size, age and sector. The log of total assets is used as proxy for company size (Noor Afza & Ayoib, 2009). Company age is measured by referring to the year of listed and it is subtracted with the date of financial year end in 2007, 2008 and 2009. This study includes five sectors in representing the control variable: industrial product, trading/services, consumer product, construction and other. These sectors were represented by dummy variables. However, during analysis the number of dummies used was one less than the number of sector categories (m-1), leaving out the dummy variable for other. Thus, four usable sectors were included in the analysis: industrial product, construction, consumer product, and trading and services.

4. RESEARCH FINDINGS

4.1. Survey respondents

A total of 186 companies responded to the survey. Out of these, nine were incomplete and two companies returned the questionnaire, leaving 175 as usable sample. According to the company secretary of two companies that returned the questionnaires, the companies have to uphold to its policies dictating that board members are not allowed to disclose their practices to outsiders. The target population was 686 companies, thus the response rate was 25%.

Out of 175 companies, 139 have single respondent and 36 companies with multiple respondents. Similar to Wan and Ong (2005), an inter-rater reliability test was carried out individually for every company that had more than one respondent to determine the level of agreement between directors in the same company. The interclass correlation coefficient shows a level of correlation coefficient (r) of board process variables in the range between 0.72 and 0.96. These values of correlation (r) are acceptable to indicate that the respondents do have the same direction or perception towards their boards as a whole. For analysis purposes, the average scores of questionnaire items were used for companies with multiple respondents.

4.2. Factor analysis and scale reliability

The result of factor analysis is shown in Table 1. A factor analysis on 31 items that relates to board process is conducted and four factors are extracted. The factors explain 63% of the board process dimension. The scale reliability for each factor under board process is calculated. Internal reliability test presents strong Cronbach Alpha values for every factor ranging from 0.722 to 0.935. Following Nunnally (1978) suggestion, the values which is above 0.7 is acceptable. Thus, the four factors under board process demonstrate a satisfactory level of reliability.

Table 1: Results of Factor Analysis

	Factor loads	Eigen value	Percent variance explained	Cumulative percent	Alpha
Factor 1: Performance of independent directors		12.720	19.067	19.067	0.935
Ability to provide strategic vision	0.775				
Effectiveness of independent directors in representing the interests of shareholders?	0.775				
Relationship with senior management	0.696				
Effectiveness of independent directors in representing the interests of stakeholders?	0.688				
Understanding of company business	0.677				
Contribution in board committees	0.650				
Record of constructively challenging and debating issues during board meetings	0.650				
Relationship with the CEO	0.601				
Ability to apply industries experience	0.601				
Interactive communication of independent directors with other board members	0.536				
Factor 2: CEO performance evaluation		3.09	17.318	36.385	0.925
Board communicates to the CEO on his/her success based on the evaluation result	0.835				
Board evaluates CEO by using KPI	0.786				
Board establishes an exit mechanism tied to CEO's performance	0.737				
Board implements a rewards system based on long term performance	0.724				
Board communicates to the CEO on his/her failures based on the evaluation result	0.721				
Board provides avenue for CEO to explain on the state of CEO's performance	0.712				

Table 1: Results of Factor Analysis *(cont)*

	Factor loads	Eigen value	Percent variance explained	Cumulative percent	Alpha
Factor 3: Board's risk oversight		1.99	15.923	52.309	0.911
Board requires senior management to deliberate on emerging risks that the senior management perceives the company will face	0.789				
Board receives updates from senior management on risk management matters	0.731				
Board raises concerns about risk management	0.712				
Board communicates on risk tolerance to senior management	0.699				
Board attends relevant risk management training	0.678				
Board reviews its strategy during crisis	0.648				
Members of board encourage senior management to use scenario analysis in identifying potential vulnerabilities	0.614				
Board has necessary financial knowledge analyze financial statements	0.584				
Factor 4: Directors' accessibility to information					
Directors discuss issues thoroughly	0.830				
Directors have access to information via management	0.816				
When directors need to refer to company business records and books of accounts, their access is denied	0.726				
When outside professional services are needed, the expenses will be borne by the company	0.726				
Directors receive sufficient materials/ information before board meetings	0.759				

4.3. Descriptive statistics

A summary of the companies participated in this study is shown in Table 2, along with the industry composition. The result denotes that industrial product represents the highest number of observation which is 59, followed by trading/ services (46), consumer product (23), construction (22) and other (25).

Table 2: Summary of the Distribution of Sample Companies by Sector

Sector	N	Percentage (%)
Industrial product	59	33.71
Trading/ services	46	26.29
Consumer product	23	13.14
Construction	22	12.58
Other	25	14.28

As shown in Table 3, the result indicates that the mean figure of ROE is 2.61. The mean value for performance of independent directors is 3.81, ranging from 2.58 to 4.80. The mean value for board's risk oversight and CEO performance evaluation is 3.97 and 3.83 respectively. Meanwhile, the mean for directors' accessibility to information is 3.68. With regards to control variables, the sample companies have RM1,880,000 of total assets and listed for 15 years on average.

Table 3: Descriptive Statistics for Company Characteristics and Board Attributes

Variables	Mean	SD	Min	Max
Return on equity	2.61	28.47	-213.89	62.58
Board's risk oversight	3.97	0.42	2.80	5.00
CEO's performance evaluation	3.83	0.46	2.48	5.00
Performance of independent directors	3.81	0.43	2.58	4.80
Accessibility of information	3.68	0.48	2.32	5.00
Company size (Total asset; RM'000)	1,880	6,787	25.84	69,643
Age of company (years)	15.28	11.64	2.00	48.00

4.4. Regression analysis

Upon running the regression analysis, the company size was transformed into logarithm to dissuade the heteroscedasticity problem. Besides, test for multicolinearity was also carried out. Independent variables with variance inflation factor (VIF) values more than 10 show a serious multicolinearity (Chatterjee, Hadi and Price, 2000). The test indicated that there is no evidence of multicolinearity since the VIF value is between the range of 1.125 and 1.791.

Table 4 shows the analysis of mediation effects of capital structure decision on the relationship between board process and company performance. As suggested by Baron and Kenny (1986), mediation regression analysis needs to go through three steps.

Table 4: Analysis on the Mediation (Company Leverage) Effects on Board Process and Company Performance

Testing steps in mediation model	Variable	Standardized Coefficient Beta	R square	R square change	F statistic
Step 1					
Dependent:	LEV				
Control:	CSIZE	0.155**			
	AGECO	-0.017			
	SECIP	0.068			
	SECCONS	0.174**			
	SECCP	-0.010			
	SECTS	0.143*			
Independent:	INDPERF	-0.142*			
	RISKOV	-0.197***			
	CEOEV	-0.214***			
	ACCESSINF	-0.158**			
			0.353	-	8.942***
Step 2					
Dependent:	ROE				
Control:	CSIZE	0.158**			
	AGECO	-0.111			
	SECIP	-0.022			
	SECCONS	0.056			
	SECCP	0.169**			
	SECTS	0.186**			
Independent:	INDPERF	0.203**			
	RISKOV	0.210**			
	CEOEV	0.044			
	ACCESSINF	0.086			
			0.219	-	4.585***

Table 4: Analysis on the Mediation (Company Leverage) Effects on Board Process and Company Performance *(cont)*

Testing steps in mediation model	Variable	Standardized Coefficient Beta	R square	R square change	F statistic
Step 3					
Dependent:	ROE				
Control:	CSIZE	0.185**			
	AGECO	-0.113*			
	SECIP	-0.010			
	SECCONS	0.086			
	SECCP	0.167**			
	SECTS	0.211**			
Mediator:	LEV	-0.173**			
Independent:	INDPERF	0.179**			
	RISKOV	0.176**			
	CEOEV	0.007			
	ACCESSINF	0.059			
			0.238	0.019	4.627***

Notes: ***, **, * indicates regression analysis is statistically significant at 1%, 5%, and 10% respectively

In the first step, the results indicate that performance of independent directors, board's risk oversight, CEO performance evaluation and directors' accessibility to information are negatively related with company leverage. The result suggests that board governance has significant influential in monitoring the capital structure decision makings. An effective board can influence the management to use other less risky financial instruments such as company internal funds (retained earnings or reserves) and equity instead of debs. With this result, the first requirement for mediation analysis is met.

In step 2, the direct effects of performance of independent directors, board's risk oversight, CEO performance evaluation and directors' accessibility to information on company performance which represented by return on equity are examined. The results indicate that performance of independent directors and board's risk oversight have strong positive relationship with company performance at p-value < 0.05 respectively. These results show that effective independent directors and boards with vigorous risks monitoring actions leads to sound company performance. Nevertheless, the other two variables of board process; CEO performance evaluation and directors' accessibility to information are found to have insignificant relationship with the company performance.

As in the third equation, the result shows that company leverage has a significant negative relationship with company performance at p-value < 0.05. The insertion of company leverage

explains an additional 1.9% of the variance in company performance. This result fulfills the third requirement of mediation analysis. Further, the coefficient for the performance of independent directors in steps 2 and 3 is reduced by 0.024; from 0.203 to 0.179, due to mediating effect of company leverage. Since the coefficient for the performance of independent directors changed when the company leverage is controlled, the result shows that there is a partial mediation effect of company leverage, suggesting that competent independent directors still have effects on company performance even when company leverage is excluded.

Meanwhile, the result in step 2 and 3 (Table 4) also show that the coefficient between board's risk oversight and company performance is reduced by 0.034, from 0.210 to 0.176. The reduction in the board's risk oversight effect after company leverage has been controlled indicates the partial mediation of company leverage. The study assumes that by devoting more attention to company risks particularly by investing in a less risky capital structure, contributes to the success of the company.

Both CEO performance evaluation and directors' accessibility to information failed to show a significant influence on company performance. These two variables do not fulfill the requirement in the second step of mediation analysis. Therefore, further test which is related to the mediation effect is not being executed. In all models, company size and company involvement in the trading and services sector are shown to have a relationship with company leverage and performance.

5. DISCUSSION AND CONCLUSION

The study attempts to find the capital structure decision effect as an intervening variable between board process and company performance. An analysis of 175 Malaysian public listed companies reveals interesting result.

The result of the study implies that decisions regarding company leverage mediate the relationship between the board's risk oversight and company performance. Boards with effective risk oversight place more emphasis on the risks that their companies might be exposed in order to determine the right capital structure decisions (Murphy & Brown, 2009). As excessive leverage creates more risks to the company, the used of minimal debt is preferable (Tam & Tan, 2007). Warrant Buffet also argues that companies must consider avoiding debt in order to succeed (Izma, 2009). Therefore, a less risky capital structure results from the board effectiveness in risk oversight, thus leading to improved company performance.

Besides, the result also indicates that effective independent directors influence management to adopt lower leverage, which in turn enhances company performance. A less risky capital structure results when an effective group of independent directors closely monitor the company financing decisions and express their ideas on the risks involved in using financial instruments (Leblanc, 2004; Pye & Pettigrew, 2005). Independent directors can apply their experience, particularly in managing company financing during financial crises, to encourage and advise the management to adopt less debt (Yeap, 2009). In an uncertain economy that

provides great challenges to businesses, companies with excessive leverage are exposed to liquidity risks (Haniffa & Hudaib, 2006) and less profitability (Tam & Tan, 2007). If the economy is not in the company's favor, companies with a low level of leverage have less risk as they do not have to struggle to pay back their debts (Keown et al., 2008). These companies are more sustainable than those with excessive leverage. This helps to explain how effective independent directors are able to influence company performance by encouraging less risky capital structure decisions.

Nevertheless, the results indicate that company capital structure does not have effect on the relationship between CEO's performance evaluation and company performance. In addition, the study fails to find the influence of capital structure decisions on the association between accessibility of information and company performance. The reasons of such results are due to the results in the second step of mediation analysis that fail to show the effect of CEO performance evaluation and accessibility of information on company performance.

With regards to CEO performance evaluation, the result is consistent with Hasnah and Hasnah (2009) who also find no association between the CEO performance evaluation and company performance. A possible explanation for this result is that the effectiveness of the CEO's evaluation procedure is different from one company to another as there is no standardized procedure. From the questionnaire survey, it is found that 124 of 175 companies (71%) have a formal evaluation process, while the remaining 51 companies (29%) conduct their evaluation process informally.

Even though the MCCG (Revised, 2007) and MCCG (2012) strongly recommend the evaluation of CEOs by the board, the code does not provide details for carrying out such assessments. Although Bursa Malaysia (2009) issues a performance evaluation sheet to assist with the evaluation process, there is still no guarantee that every public listed company follows the template. Besides, company ownership also influences the evaluation process. Directors that have family ties with the controlling shareholders may reduce the effectiveness of the CEO's evaluation (Westphal, 1999) due to the close relationship between them.

The result also demonstrates that the directors' accessibility to information and company performance are not significantly related, though it does show a positive regression coefficient. A possible explanation for the insignificant result is that the effectiveness of board in attaining access to company information could be best identified in the event of a company facing operational difficulties. At such times, directors are more likely to devote extra attention to monitoring the management decisions. The directors' discussions, preparations and participation during board meetings tend to be more thorough when the business faces difficulties (Vafeas, 1999). Vafeas (1999) finds that company performance is likely to improve with frequent and high-quality board meetings. The direction of the result is similar to Kula and Tatoglu (2006) and Hasnah and Hasnah (2009).

Company size is other influential factor on company performance. Large companies tend to have more diversified activities (Kyereboah-Coleman, 2007), better disclosure (Fauzias & Bany, 2005) and more liquid (Fu et al., 2002), all of which may lead to sound company

performance. Further, the trading and services sector is found to have a positive impact on company performance. Under the 9th (2006 to 2010) and 10th (2011 to 2015) Malaysian Plans, the Malaysian government has identified the trading and services business as one of the potential new growth sectors in the economy. This sector is expected to grow at 7.2% annually until 2015 (Malaysian Investment Development Authority, MIDA). The sector has been given various promotions to attract investors and incentives, which influence company performance. The result in this study is consistent with Haniffa and Hudaib (2006) and Noor Afza (2011b).

In the capital structure decision making process, managers always get to push through their preferences, which focus on debt instead of equity (Myers, 2001). Therefore, shareholders have to rely on the board of directors to evaluate and challenge management decisions. However, shareholders are under disadvantage if the decision turns out to be inefficient and very risky due to poor monitoring by the directors, which further reinforces the need to assess the board process in influencing capital structure decisions.

The findings of the study suggest that board process is essential to the quality of company performance and capital structure decisions. The findings assist the board members to maximize their contributions to the stakeholders. By understanding the different dimensions of board process, the board could perform better during board deliberation. In the findings, the CEO performance evaluation by the board is found to be an essential determinant of capital structure decisions and company performance. As such, regulators, companies, shareholders and board members should emphasize the importance of more transparent evaluations, the details of which should be disclosed publicly. Specifically, regulators (particularly the Securities Commission) should specify the minimum requirement for evaluating the CEO's performance in the code. Besides, this study contributes to board literatures whereby the directors' duties in monitoring company risks and CEO performance evaluation are discussed in depth. With regards to theory, the use of agency theory in board process studies is still lacking (Hasnah & Hasnah, 2009). Therefore, this study applies the agency theory in the context of board process. The result indicates that board process variables influence company leverage and performance. Vigorous monitoring by the board tends to put pressure on management, causing the managers to be more prudent in decision makings. This in turn, brings positive effect to company capital structure decisions and performance.

With regards to future research, the dimension of board process need to explore further as board of director is seen as an important mechanism in corporate governance. Other board process variables such as managing conflicts and communication among board members may be included in future research.

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