

Capital Structure and Firm Performance in Government-Linked Companies: Moderating Role of Board Composition and Ethnic Diversity

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ABSTRACT

The performance of state-owned enterprises (SOEs) has been subjected to a wide range of debate around the globe. In Malaysia, SOEs or government-linked companies (GLCs) play a significant role in shaping the economy. This study investigates whether GLCs with large debts suffer from poor financial performance as proposed by Public Choice Theory, and whether corporate governance mechanisms and board diversity as suggested by Agency Theory and Human Capital Theory can moderate the impact of debt on the GLCs' financial performance. Utilizing longitudinal data from 20 largest GLCs listed on Bursa Malaysia from 2005 to 2019, our results show that the negative relationship between leverage and financial performance is not statistically significant, hence Public Choice Theory is not supported. CEO duality is found to significantly exacerbate the negative relationship between leverage and financial performance, while a higher proportion of independent directors attenuate, thus supporting Agency Theory. We also found that ethnic diversity weakens the negative relationship between leverage and financial performance, supporting the presumption in Human Capital Theory that diversity in personalities strengthen organizational performance. This study offers theoretical and policy implications surrounding corporate governance practices.

Keywords: Financial performance; corporate governance; state-owned enterprises; leverage; board diversity; government-linked companies

INTRODUCTION

State-owned enterprises (SOEs) Are entities owned by the state, which generally serve as the backbone in a nation's economy (Hafsi et al. 1987; Tian & Chen 2022). The significance of SOEs is prevalent in many countries around the globe, and it is estimated that SOEs in developing economies account for approximately 25% to 50% of the nation's gross domestic product (Kane & Christiansen 2015). The impetus of SOEs' importance to their respective countries is centred on the setting of objectives for entities that are geared towards meeting the needs of society's overall economic well-being. Thus, SOEs are generally faced with unique challenges in comparison to for-profit organizations.

Critics of SOEs argue that their objectives, which differ from for-profit organizations, lead to suboptimal operations. This burdens the government who are compelled to oversee the financial aspects of these entities, particularly when SOEs are faced with financial difficulties during an economic slowdown. To improve both the performance of these "suboptimal" SOEs and to curb outflow of resources from government in assisting SOEs, many countries have taken steps to privatize these entities. However, despite privatization, many of these nationalized entities remain under government's ownership and "control". These "transformed" SOEs are also known as "hybrid" organizations (Bruton et al. 2015; Powell et al. 2019) as reflected by their "management" (because they are managed privately) and "control" (government policies) policies.

PROBLEM STATEMENT

Despite being managed as "hybrid" organizations, the privatization of SOEs does not seem to be a "quick fix" to the inefficiencies and "suboptimal" performance that is predominantly plaguing these entities. In this part of the region, such as in Malaysia and Singapore, privatized SOEs are more commonly referred to as Government-Linked Companies ("GLCs"). GLCs are typically "transformed" SOEs – i.e., entities that are driven based on a business model. They are bound to provide return to their investors yet concurrently, they are "obliged" to fulfil the country's socio-economic objectives. Although these SOEs were privatized with the objectives of relieving the government from financial burden, many of the privatized SOEs suffer from poor financial performance because the requirement to fulfil the country's economic objectives restrict their abilities as a business entity. Moreover, since SOEs are government-owned, these entities, to a certain extent, place a huge burden on the government as financial resources are used to bail out the distressed SOEs. Prior literature has highlighted that capital structure is important for firm growth profitability. Moreover, deviation from a target capital structure is argued to be related to the quality of corporate governance (Miloud 2022). Given the importance of GLCs to the economy and the often-poor performance of GLCs frequently noted in the literature, it is worthwhile to explore the link between financial leverage and profitability and how corporate governance influence this relationship in the context

of GLCs. In addition, it is further argued that corporate governance mechanisms would have significant impact in moderating the relationship between the level of leverage and the entities' financial performance. The panacea to address the inefficiencies of SOEs is aimed towards restructuring its structure and administrative functions.

Armed with this underlying premise and the concerns highlighted in previous literature, this study is accordingly directed by two research objectives. First, to ascertain whether capital structure denoted by leverage has an impact on the financial performance of Malaysian GLCs. Second, whether corporate governance mechanisms moderate the relationship between leverage and financial performance of Malaysian GLCs. In deliberating the research objectives for this study, the ultimate purpose guiding our approach is based on the concept of applying theories in empirical management and business research (Sutton & Staw 1995). Our approach is ultimately guided by advances in strategic management that have *“resulted from the application of formal deductive methods, based on tests of specific hypotheses derived from theory”* (Graebner 2023).

LITERATURE REVIEW

This section begins by discussing the background of GLCs in the Malaysian context, followed by the financial performance and the theoretical perspectives adopted in this study. The financial performance of the GLCs is the pinnacle of discussion in this section given the changing nature of the SOEs into “hybrid” organizations. Accordingly, the theoretical underpinnings are discussed in order to delve further on the underlying premise that serves as the root cause or the impetus of expected change in the financial performance. The corporate governance literature is then offered to further investigate whether the current requirement in the Malaysian corporate governance landscape would also contribute towards improving the financial performance of the GLCs.

BACKGROUND OF SOEs AND GLCs IN MALAYSIA

The terms SOE and GLC are two terms that are frequently used in this study. The following explanations are offered in discussing the main conceptions governing these two terms.

The “traditional” view of SOEs is focused on the ownership of the entities; the main differences lie in the objectives surrounding their establishments. The establishment of SOEs from the concept of public administration is based on the societal attributes and needs, particularly in the areas of economic achievement. Funded by the government, “traditional” SOEs undertake business activities, but profit motives are not its central focus. Hence, it is contentiously debated that SOEs are not motivated to perform financially, resulting in suboptimal performance. This circumstance was made worse by the global economic slowdown in the mid-1980s, leading to

the emergence of the New Public Management (NPM) concept. NPM called for better managed public entities. This signifies a critical move which had given rise to the emergence of a “hybrid” form of SOEs.

It has been argued that the unceasing existence of the SOEs around the world is due to its evolution from a “traditional” to a “hybrid” organization (Bruton et al. 2015; Diefenbach & Sillince 2011; Inoue 2013; Powell et al. 2019). The “traditional” SOEs are based on decisive directories of the enterprises demarcated as being “state-owned” and thus publicly managed and administered, in addition to being financially dependent on the state's resources to thrive. The fact that SOEs are publicly owned and managed, justifies the need for the state to manage the entities' financial affairs. However, in “hybrid” organizations such as the GLCs, while the GLCs (referring to the Malaysian and Singaporean context) are typically run and managed as commercial organizations; these entities are “atypical” to the “purely” private organizations as GLCs are expected to meet the state's socio-economic objectives and political goals. GLCs comprise of mixed state and private ownership; alongside a mixture of persons in the management team. Thus, the varying level of “interests” in GLCs lead to conflicting and diverging interests.

The establishment of SOEs in Malaysia was the result of the implementation of the affirmative policy implemented by the Malaysian government. The National Economic Policy (NEP) was formulated to address poverty and economic inequalities that persisted between the major racial groups (Osman-Rani 2019; Soong 2008). Many state agencies were converted into enterprises, with the main socio-economic aims of providing occupation to the *Bumiputeras* – i.e., “the sons of the soil”. Faced with economic slowdown due to the global recession in the mid-1980s, the government was compelled to relieve its financial burden by privatizing SOEs. Despite privatization, government ownership was retained, hence, these entities are known as “government linked companies” (GLCs).

Notwithstanding the move to privatize SOEs, past studies found that GLCs underperform financially compared to privately owned companies. It was reported that the estimated total amount used to bail out financially troubled GLCs was distressingly high at RM85.51 billion (Mahavera & Leong 2017).

To restructure and improve the performance of GLCs, the Malaysian government has launched the GLC Transformation Programme in May 2004. The main objective of the programme was to spur the growth of the Malaysian economy through the enhancement of GLCs' performance. The main objective essentially focuses on governance, shareholder value and stakeholder management. The definition of GLC is offered in the GLC Transformation Manual in the Appendix Section, Section IV, as follows:

“Government-Linked Companies (GLCs) are defined as companies that have a primary commercial objective and in which the Malaysian Government has a direct controlling stake.

(Putrajaya Committee on GLC High Performance (PCG) 2006, Section IV, Appendix)

The definition of a GLC is in line with SOE as discussed earlier, as there is an inherent government ability to “control” the entities.

Collectively, GLCs account for approximately 36%; slightly more than one third of the Malaysian capital market, as reported in 2005 (Putrajaya Committee on GLC High Performance (PCG) 2006). PCG highlighted that the twenty largest GLCs are denoted as G20. In 2021, GLCs presence in the Malaysian capital market has increased to 42% (Business News, 30th October 2021), which demonstrates the significance of the GLCs contribution to the Malaysian economy.

The essence of the debate surrounding the performance of GLCs is on the nature and characteristics of these entities. Given the intricate need to balance diverging interests amongst ownership and management, are these GLCs able to perform financially?

THE FINANCIAL PERFORMANCE OF SOEs AND GLCs

Much of the discussion in the literature does not differentiate the extent of the mixture of state-private ownership in hybrid SOEs and traditional SOEs. Hence, this section provides a discussion surrounding the financial performance of the respective entities, using the terms SOEs and GLCs interchangeably to reflect the contexts of the discussion.

Despite the immense challenges in balancing diverging needs, studies report that GLCs in Singapore are, by and large, efficiently managed, have good financial performance and are at par with the performance of the “purely” private business entities. A study conducted from 1990 to 2000 found that Singaporean GLCs have better corporate governance and higher valuations in comparison to non-GLCs (Ang & Ding 2006). Conversely, internationally, the financial performance of GLCs report mixed results. In a study of 25 Canadian SOEs from 500 largest corporations, it was found that state ownership negatively impacts the financial performance of SOEs when SOEs have to fulfil other objectives apart from profit-maximisation goals (Bozec & Breton 2003). Interestingly, it was found that the financial performance of these SOEs significantly improved upon corporatization (Bozec & Breton 2003).

A study of 69 SOEs in Central and Eastern Europe finds that the financial performance of SOEs are comparable to privately owned entities, with SOEs exhibiting higher solvency ratios compared to privately owned enterprises (Szarzec & Nowara 2017). Similarly, a study of 62 GLCs and 52 non-GLCs in the United Arab Emirates finds that GLCs have better financial performance than non-GLCs. However, the best accounting results is when the

government ownership is between 20% to 50% compared to above 50% ownership (Uddin et al. 2014).

Financial assistance and subsidies provided to SOEs also incite research. In China, government subsidies appear to have a significant effect on the financial performance of wind energy manufacturing companies (Zhang et al. 2014). Conversely, a study that focuses on new energy companies in China from 2010 to 2016 found that government subsidies have no effect in improving the financial performance of SOEs in the renewable energy sector. In Indonesia, government subsidies were found to have a negative impact on the financial performance of SOEs from 2005 to 2016 (Assagaf et al. 2017). Meanwhile, in a more recent study it was found that SOEs in Europe underperform the non-SOEs financially (Matuszak & Kabaciński 2021).

Previous literature discusses the impact of capital structure on firms’ profitability. Specifically, this study extends Ayaz et al. (2021) by examining the link between financial leverage on firm profitability in the context of GLCs. Additionally, this study also includes corporate governance as a moderator variable since prior studies have argued that deviation from a target capital is related to the quality of corporate governance (Miloud 2022). Also, prior literature highlighted that poor corporate governance in the GLCs is a reason for their inferior performance (Ma et al. 2022). In light of the gap in the literature as discussed above, this paper offers theoretical insights that serve as the underlying presumption for the constructs and relationships amongst the constructs developed in this research. This is discussed in the following section.

THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT

Previous studies outlined the challenges faced in managing SOEs due to its “hybrid” nature and diverging objectives. The presumptions in Public Choice Theory points to fundamental “shortcomings” in exercising the state function in managing GLCs as an active participant, rather than a purported regulator. This study adopts the Public Choice lens in an attempt to explain this phenomenon. Moreover, because GLCs are entities that are managed in a manner similar to privately owned companies, corporate governance mechanisms are viewed as an approach to effectively curtail the self-interest behaviour of the management. Hence, Agency Theory is applied as a supporting theory. Additionally, board diversity as proposed by Human Capital Theory contributes to the overall board dynamics.

LEVERAGE AND GLC’s PROFITABILITY PERFORMANCE

Unlike the profit-driven “purely” private entities, the extent of the “pressure” to earn and yield profits is inherently low in SOEs. Hence, there is less motivation for the management of SOEs to steer these entities away from financial difficulties.

Propagated by Buchanan (1983) who deliberated why the market fails, this notion was extended to include public sector and the government (Buchanan 1983). The fundamental tenet in this theory is that collectively, political agents are engaged in self-interested behaviour (Mueller 1976) which propelled their actions to conflict with the overall interests of the general public (Cabral et al. 2019; O'Fallon 1993). While this theory does not directly presume the negative relationship between leverage and financial performance, the theory postulates that in comparison with the pure "for-profit" organization, the management of SOEs do not have strong inclination to closely monitor long term loans, borrowings and the leverage of SOEs, compared to private entities. Hence, this will be detrimental to SOEs in the long term because high leverage from huge borrowings is likely to result in poor financial performance, especially in instances when high leverage is not coupled with effective and efficient leverage management. Consequently, we hypothesize that:

H₁ Leverage negatively influences the financial performance of the GLCs.

MODERATING ROLE OF BOARD COMPOSITION AND ETHNIC DIVERSITY

The lack of motivation by the SOEs' and GLCs' management to oversee and monitor the entities' performance are addressed through the implementation of corporate governance mechanisms, which includes enhancing board diversity. This resonates with the underlying presumption in agency theory that monitoring mechanisms are needed to resolve the conflict between principals and agents. Given that there are other factors that could influence the relationship between leverage and profitability (Ayaz et al. 2021; Jiang et al. 2019), this study includes corporate governance as a moderator. Corporate governance is chosen because prior literature highlights that poor corporate governance in GLCs is a reason for their inferior performance (Ma et al. 2022).

It is argued that CEO duality leads to poor financial performance, because the CEO's decisions are not challenged by the chairman since the CEO is also functioning as the chairman of the board. CEO duality is found to negatively impact firm performance (Veprauskaitė & Adams 2013). Hence, if CEO duality is inherent in SOEs or GLCs, this will further strengthen the negative relationship between leverage and financial performance. Meanwhile, larger board size improves the financial performance of SOEs (Al Farooque et al. 2020). Larger board size contributes towards effective decision making of the overall board. In entities laden with huge debt, boards with larger size are able to steer SOEs to reduce debt. Higher proportion of independent directors positively impacts the firms' financial performance (Masulis & Mobbs 2014), because boards with higher proportions of independent directors can better monitor

personal agendas by any members of the board. Hence, higher proportion of independent directors are likely to have a positive influence on firms' financial performance. Taken together, we predict that:

H_{2a} EO duality negatively influences the relationship between leverage and the financial performance of the GLCs.

H_{2b} Larger board size positively influences the relationship between leverage and the financial performance of the GLCs.

H_{2c} Higher proportion of independent directors positively influences the relationship between leverage and the financial performance of the GLCs.

According to Human Capital Theory, the diversity, uniqueness and essential qualities of the board serves as tangible valuable capital which enable the organization to steer towards better financial performance. Human Capital Theory postulates that development of human capital is not confined to their respective education and cognitive skills but is also shaped by its sociological influences and perspectives (Tomaskovic-Devey et al. 2005).

Hence, diversity within the board would assist in creating different perspectives and contributes towards more effective management in several ways. First, a gender and racially diverse board bring different resource linkages to external entities that can benefit a firm's performance, since firms acquire competitive advantages through linkages to external entities (Hillman et al. 2007; Post & Byron 2015). Second, the amount of different nature and types of information offered by a diverse board especially during board meetings have crucial impact for better leverage management, thereby enhancing firm performance and competitiveness (Fan 2019; Hossain & Oon 2022). Moreover, directors with broader access to external information and resources can increase their ability in monitoring and advising (Bebchuk & Weisbach 2010; Zalata et al. 2019), hence supporting the notion that a gender and racially diverse board will promote better leverage management, leading to better firm performance. Third, a diverse board, such as having a Malay politically connected director (Gul et al. 2016, (Abdullah & Ku Ismail 2013) and a female director (Adams & Ferreira 2009; Bozhinov et al. 2021) brings valuable advice and counsel through the different demographic and relational attributes they bring to the boardroom, resulting in higher quality board discussions (Bennouri et al. 2018). In addition, female directors provide fresh viewpoints, divergent and independent thinking, stimulate creativity and allocate more monitoring efforts since women are generally more risk averse and less tolerant of opportunistic behaviour than men (Adams & Ferrera 2009, (Bennouri et al. 2021; Fan et al. 2019; Zalata et al. 2019) . Thus, higher female representation on the board,

alongside higher proportion of racial diversity encourages board members to effectively exert influence to reduce the level of leverage, leading towards improved financial performance of GLCs. Hence, we hypothesize that:

H_{2d} Higher proportion of female directors positively influences the relationship between leverage and the financial performance of the GLCs.

H_{2c} Higher proportion of racial board diversity positively influences the relationship between leverage and the financial performance of GLCs.

Based on the underlying theoretical premise, we develop the following conceptual framework, as depicted in Figure 1 below:

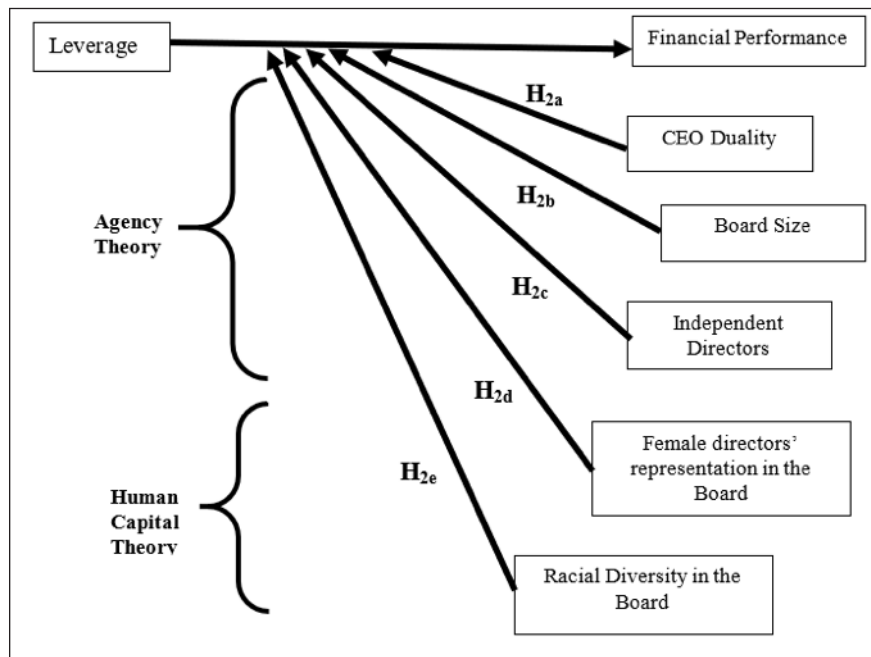


FIGURE 1. Conceptual framework

This section outlines the methodological aspects of the study which include sample size, measurement of variables and empirical models.

SAMPLE

Data is obtained from annual reports listed on Bursa Malaysia’s website. To test our hypotheses, we collected financial and corporate governance data of the largest 20 GLCs listed in Bursa Malaysia over a period of 15 years, from 2005 until 2019, providing a balanced panel dataset of 300 observations. The list of the 20 GLCs is shown in the Appendix. This sample period is chosen because there is limited longitudinal study on GLCs although they provide important contributions to the Malaysian economy. Additionally, “The GLC Transformation Programme” was launched in May 2005 and was part of an on-going effort by the Government to drive development and stimulate the economy. Accordingly, our sample selection starts in the year in which the programme was launched. Moreover, among the key initiatives of the GLC Transformation Programme includes board composition, which is among the variables that is included in this study. Additionally, the 2017 revision on Malaysian Code of Corporate Governance included a recommendation that

large companies needed to have 30% women directors on their boards.

While the results of Shapiro-wilk, skewness and kurtosis show that the data is not a normal distribution, the pooled t-statistic has a limiting normal distribution of the data due to the larger size of cross-section and time-series dimensions of the panel dataset (Levin et al. 2002).

DEPENDENT, INDEPENDENT AND MODERATOR VARIABLES

The dependent variable is firm performance. This study measures firm performance using Tobin’s Q, a market-based measure and return on assets (ROA), an accounting-based measure. The independent variable is leverage (LEV) (Kao et al. 2019). There are several corporate governance variables that act as moderator variables in this study. The first moderator variable is racial diversity. This study uses two different measures for racial diversity; namely the Blau’s index for heterogeneity (BLAUINDEX_RACE) and the percentage of non-Malay on the board of directors (RAC_DIV). Blau’s (1977) index of heterogeneity is stated as $1 - \sum p_i^2$, where p_i is the proportion of group members in each of the i number of categories. Following Gul et al. (2016), we categorized the ethnicity of board members into four categories:

Malay, Chinese, Indian and foreigners. To identify the ethnicity, we examined the names and photos in annual reports based on the information provided in the directors' profiles section of the annual reports. All four categories were used to calculate Blau's index. Other moderator variables are percentage of independent directors (INDE_DIR), percentage of female directors (FEM_DIR) on the board, CEO duality (CEO_Dual) and board size (B_SIZE). Table 1 provides the definition and measurement for all our variables.

CONTROL VARIABLES

In line with prior studies, the control variables in this study include the following: firm size, firm growth, firm age, labour size and labour intensity. Firm size (TOTAL_ASSETS) is measured by the natural logarithm of book value of total assets (Ting 2021; Yang & Zhao 2014), while firm growth (TOTAL_SALES) is measured by the natural logarithm of book value of total sales (Zhao et al. 2018). Firm age (FIRM_AGE) refers to the number of years since the firm was first incorporated as a public company (Al Farooque et al. 2020). Labour size (LABOUR_SIZE) is measured by the natural logarithm of the total number of employees (Zhao et al. 2018) and labour intensity (LABOUR_INTENSITY) is measured by employees divided by the total sales (Phi 2020).

Model 1:

$$\text{TOBIN'S Q} = \beta_0 + \beta_1(\text{LEV}) + \beta_2(\text{CEO_DUAL}) + \beta_3(\text{B_SIZE}) + \beta_4(\text{INDE_DIR}) + \beta_5(\text{FEM_DIR}) + \beta_6(\text{BLAUINDEX_RACE}) + \beta_7(\text{LEV_CEO_DUAL}) + \beta_8(\text{LEV_B_SIZE}) + \beta_9(\text{LEV_INDE_DIR}) + \beta_{10}(\text{LEV_FEM_DIR}) + \beta_{11}(\text{LEV_BLAUINDEX_RACE}) + \beta_{12}(\text{TOTAL_ASSETS}) + \beta_{13}(\text{TOTAL_SALES}) + \beta_{14}(\text{FIRM_AGE}) + \beta_{15}(\text{LABOUR_SIZE}) + \beta_{16}(\text{LABOUR_INTENSITY}) + \epsilon_t$$

Model 2:

$$\text{TOBIN'S Q} = \beta_0 + \beta_1(\text{LEV}) + \beta_2(\text{CEO_DUAL}) + \beta_3(\text{B_SIZE}) + \beta_4(\text{INDE_DIR}) + \beta_5(\text{FEM_DIR}) + \beta_6(\text{RAC_DIV}) + \beta_7(\text{LEV_CEO_DUAL}) + \beta_8(\text{LEV_B_SIZE}) + \beta_9(\text{LEV_INDE_DIR}) + \beta_{10}(\text{LEV_FEM_DIR}) + \beta_{11}(\text{LEV_RAC_DIV}) + \beta_{12}(\text{TOTAL_ASSETS}) + \beta_{13}(\text{TOTAL_SALES}) + \beta_{14}(\text{FIRM_AGE}) + \beta_{15}(\text{LABOUR_SIZE}) + \beta_{16}(\text{LABOUR_INTENSITY}) + \epsilon_t$$

REGRESSION MODELS

We estimate our panel dataset using Pooled Ordinary Least Squares (POLS) to test our hypotheses on the relationship between leverage and firm performance as depicted by Model 1 and 2. The pooled OLS regression is the most commonly considered model for our small sample of panel dataset since it is better at handling existing multicollinearity and the presence of autocorrelation and heteroscedasticity. To ensure comprehensiveness, we conducted the VIF test for multicollinearity for both Model 1 and 2. The VIF values for all our independent variables are below the threshold of 10, with a mean VIF value of 2.73. This indicates that the independent variables in our models are free from multicollinearity. Model 1 is based on the ethnic diversity measured by Blau's index (BLAUINDEX_RACE), while Model 2 is based on the percentage of non-Malays directors divided by the total number of directors on the board (RAC_DIV). Both measures are widely used in past studies of ethnic diversity. Because ethnic diversity is measured in varying ways, this study employs different measurements of ethnic diversity, as expressed in Model 1 and Model 2 below.

TABLE 1. Definition of variables

Variable	Definition & Measurement
TOBIN'S Q	Book value of total assets minus book value of total equity plus market value of common equity divided by book value of total assets.
ROA	Net profit after tax divided by total assets.
LEV	Total debt divided by total assets.
CEO_DUAL	Coded as "1" if the firm has a stable duality status for the entire observation study period (2005-2019); otherwise "0" if the firm has a stable non-duality status. A firm is defined as having a stable duality or non-duality status, for more than 80% firm-years for a minimum of four years from 2005 to 2019.
B_SIZE	Natural logarithm of total number of directors on the board.
INDE_DIR	Number of independent directors divided by the total number of directors on the board (%).
FEM_DIR	Number of female directors divided by the total number of directors on the board (%).
BLAUIINDEX_RACE	Blau's measure of racial diversity as measured by $1 - \sum \rho_i^2$, where ρ_i is the proportion of group members in each of the i number of categories.
RAC_DIV	Number of non-Malay directors divided by the total number of directors on the board (%).
TOTAL_ASSETS	Natural logarithm of book value of total assets.
TOTAL_SALES	Natural logarithm of total sales.
FIRM-AGE	Number of years since firm incorporation.
LABOUR_SIZE	Natural logarithm of the total number of employees.
LABOUR_INTENSITY	Total number of employees divided by the total sales.

RESULTS AND DISCUSSION

This section presents the results of the study, specifically the descriptive statistics and the regression results. This is followed by discussion of the findings.

DESCRIPTIVE STATISTICS

Table 2 shows the descriptive statistics for the studied variables. From Table 2, the mean for Tobin's Q is 0.496, which is higher than the mean of ROA at 0.023. This shows that the market value of the GLCs' equity is much higher than the corresponding book value. Meanwhile, the mean for ethnic diversity, Blau's index (BLAUIINDEX_RACE) is 0.292 which suggests that the probability of selecting two ethnically different members of the board at random

is rather low, indicating that the composition of members in the board is not highly diverse. The mean for the other measure of ethnic diversity, percentage of non-Malay on the board (RAC_DIV) is 0.192, suggesting that over the 15-year period of the study, the composition of non-Malay on the board is on average, approximately 20%. Both the mean for diversity, BLAUIINDEX_RACE and RAC_DIV implies that the ethnic diversity in the GLCs is not profoundly diverse. Regarding board composition variables, the mean proportion of independent directors (INDE_DIR) is approximately 48% of total board members while the mean for female directorship (FEM_DIR) is approximately 11% and CEO duality (CEO_DUAL) occurs in 5% of the analysed companies.

TABLE 2. Descriptive statistics (N = 20)

Variable	Mean	Median	Min	Max	S.D
TOBIN'S Q	0.496	0.383	0.10	1.00	0.257
ROA	0.023	0.02	-0.22	0.19	0.047
LEV	0.220	0.2	0	1.03	0.163
CEO_DUAL	0.05	0	0	1	0.218
B_SIZE	2.107	2.197	0.69	2.83	0.284
INDE_DIR	0.480	0.5	0	1	0.151
FEM_DIR	0.110	0.1	0	0.5	0.120
BLAUIINDEX_RACE	0.292	0.346	0	0.74	0.210
RAC_DIV	0.192	0.21	0	0.55	0.147
LEV_CEO_DUAL	0.006	0	0	0.26	0.027
LEV_B_SIZE	0.467	0.418	0	2.00	0.348
LEV_INDE_DIR	0.109	0.091	0	0.59	0.096
LEV_FEM_DIR	0.024	0.006	0	0.18	0.035
LEV_BLAUIINDEX_RACE	0.067	0.048	0	0.42	0.075
LEV_RAC_DIV	0.044	0.031	0	0.29	0.052
TOTAL_ASSETS	16.716	16.740	12.22	20.54	1.629
TOTAL_SALES	15.449	15.705	11.63	17.75	1.456
FIRM_AGE	76.446	62	8	219	53.83
LABOUR_SIZE	9.253	9.750	5.83	11.00	1.160
LABOUR_INTENSITY	0.004	0.002	0.00	0.06	0.007

REGRESSION RESULTS

Table 3 and 4 show the regression results for hypothesis testing using different measures of board diversity, BLAUIINDEX_RACE (Model 1) and RAC_DIV (Model 2) respectively. From these tables, the R-square value for TOBIN'S Q is high at 67%, suggesting that this market-based measure is more capable of explaining the variation in the dependent variable, i.e., financial performance, compared to ROA, the accounting-based measure. Hence, the results based on TOBIN'S Q is used in examining the details of the findings, while results based on ROA is used as robustness check. At -0.122 (Table 3) and -0.165 (Table 4), the beta coefficients of TOBIN'S Q show that the negative relationship between leverage and financial performance is not significant. Therefore, hypothesis H_1 which hypothesizes that leverage negatively affects the financial performance of GLC is not supported. In addition, this result also holds when different measures of board diversity, the Blau's Index (BLAUIINDEX_RACE) and the proportion of different races to Malay directors (RAC_DIV), are being used.

At -0.994 (Table 3) and -1.071 (Table 4), the beta coefficient for the moderating variable LEV_CEO_DUAL show that there is a highly significant negative impact on TOBIN'S Q ($p < 0.01$). Hence, Hypothesis H_{2a} which hypothesizes that a negative relationship between leverage and the financial performance of the GLCs will be stronger with CEO duality, is supported. Meanwhile, Table 3 and 4 show that H_{2c} which hypothesizes a negative relationship between leverage and the financial

performance of the GLCs will be weaker with a higher proportion of independent directors, is also supported. This is indicated by the beta coefficient values of LEV_INDE_DIR at 0.946 (Table 3) and 0.860 (Table 4), both significant at $p < 0.05$. Also supported is H_{2c} , which hypothesizes that the negative relationship between leverage and the financial performance will be weaker when there is a higher proportion of racial board diversity. Table 3 and 4 shows that the beta coefficient at 1.500 and 2.070 respectively, is positive and highly significant at $p < 0.01$, as indicated by the variables LEV_BLAUIINDEX and LEV_RAC_DIV respectively.

However, our results do not support Hypothesis H_{2b} and H_{2d} . Hypothesis H_{2b} hypothesizes that the negative relationship between leverage and the financial performance of the GLCs will be weaker with a larger board size, denoted by the variable LEV_B_SIZE. From Table 3, the coefficient for LEV_B_SIZE is -0.508 and in Table 4, the coefficient is -0.450, both significant at $p < 0.10$. Since LEV_B_SIZE shows a negative impact on Tobin's Q, this means that a larger board size strengthens the negative relationship between leverage and the financial performance of the GLCs. Thus, hypothesis H_{2b} is not supported. Hypothesis H_{2d} which hypothesizes that the negative relationship between leverage and the financial performance of the GLCs will be weaker with a higher proportion of female directors as executive or non-executive directors, is also not supported. From Table 3, the coefficient LEV_FEM_DIR is -0.768 and in Table 4, the coefficient is -0.830, both significant at $p < 0.10$. Since

LEV_FEM_DIR shows a negative impact on Tobin's Q, it means that a higher proportion of female directorship strengthens the negative relationship between leverage

and the financial performance of the GLCs. Thus, hypothesis H_{2d} is not supported.

TABLE 3. Pooled OLS Regression for Blau's Index of Racial Diversity – Model 1

	TOBIN'S Q	
	β Coef.	T
LEV	-0.122	-0.290
CEO_DUAL	0.214	4.610***
B_SIZE	-0.060	-1.600
INDE_DIR	-0.206	-2.490**
FEM_DIR	0.003	0.010
BLAUINDEX_RACE	-0.390	-16.530***
LEV_CEO_DUAL	-0.994	-4.670***
LEV_B_SIZE	-0.508	-2.040*
LEV_INDE_DIR	0.946	2.850**
LEV_FEM_DIR	-0.768	-1.760*
LEV_BLAUINDEX_RACE	1.500	6.300***
TOTAL_ASSETS	0.140	13.760***
TOTAL_SALES	-0.135	-6.130***
FIRM_AGE	0.001	3.400***
LABOUR_SIZE	-0.002	-0.070
LABOUR_INTENSITY	-6.944	-1.610
Constant	0.646	3.090***
R-squared		0.67
Prob > F		0.000
N		300

Beta coefficient and significant at (* p < 0.10), (** p < 0.05), (***) p < 0.01)

TABLE 4. Pooled OLS Regression for proportion of different races to Malay directors – Model 2

	TOBIN'S Q	
	β Coef.	T
LEV	-0.165	-0.370
CEO_DUAL	0.245	5.220***
B_SIZE	-0.068	-1.720
INDE_DIR	-0.193	-2.510**
FEM_DIR	0.020	0.110
RAC_DIV	-0.583	-15.200***
LEV_CEO_DUAL	-1.071	-5.310***
LEV_B_SIZE	-0.450	-1.790*
LEV_INDE_DIR	0.860	2.760**
LEV_FEM_DIR	-0.830	-1.850*
LEV_RAC_DIV	2.070	6.890***
TOTAL_ASSETS	0.138	12.520***
TOTAL_SALES	-0.131	-6.240***
FIRM_AGE	0.001	3.420***
LABOUR_SIZE	-0.005	-0.170

continue ...

... continued

LABOUR_INTENSITY	-6.863	-1.580
Constant	0.640	3.100***
R-squared		0.67
Prob > F		0.000
N		300

Beta coefficient and significant at (* p < 0.10), (** p < 0.05), (***) p < 0.01)

ROBUSTNESS CHECKS

For robustness checks, we use ROA, the accounting measure of firm performance, as our alternative dependent variable to validate our expectations and results. Table 5 and Table 6 depicts the regression results for Model 1 and Model 2 using ROA as the dependent variable. Similar to our main analysis using Tobin's Q as the dependent variable, we do not find significant results in support of H₁ (leverage and firm performance), H_{2b} (board size) and H_{2d} (proportion of female directors). As expected, we found similar levels of significance for H_{2a} (CEO duality), H_{2c} (proportion of independent directors) and H_{2e} (racial board diversity). However, due to differences

in the nature of Tobin's Q (which is a market measure of firm value) and ROA (which is an accounting measure that indicates how effectively companies utilizes assets to generate profits), there are differences in the sign of these results. This suggests that although the market positively perceives the absence of CEO duality and the greater proportion of independent directors and racial board diversity, this may not be reflected in historical accounting numbers. Differences in results due to the use of accounting-based and market-based measures of performance in the Malaysian context are similar to findings by Haniffa & Hudaib (2006) and Amin & Noor (2019).

TABLE 5. Pooled OLS Regression for Blau's Index of Racial Diversity – Model 1

	ROA	
	β Coef.	T
LEV	-0.069	-0.330
CEO_DUAL	-0.023	-2.140**
B_SIZE	-0.016	-0.650
INDE_DIR	0.052	3.490***
FEM_DIR	-0.042	-0.930
BLAUINDEX_RACE	0.008	0.450
LEV_CEO_DUAL	0.148	3.270***
LEV_B_SIZE	0.120	1.070
LEV_INDE_DIR	-0.404	-3.590***
LEV_FEM_DIR	0.120	0.720
LEV_BLAUINDEX_RACE	-0.182	-2.510**
TOTAL_ASSETS	-0.005	-1.530
TOTAL_SALES	0.025	11.180***
FIRM_AGE	-0.000	-0.290
LABOUR_SIZE	-0.020	-7.640***
LABOUR_INTENSITY	3.359	6.940***
Constant	-0.091	-2.080*
R-squared		0.31
Prob > F		0.000
N		300

Beta coefficient and significant at (* p < 0.10), (** p < 0.05), (***) p < 0.01)

TABLE 6. Pooled OLS Regression for proportion of different races to Malay directors – Model 2

	ROA	
	β Coef.	T
LEV	-0.062	-0.290
CEO_DUAL	-0.026	-2.210**
B_SIZE	-0.017	-0.670
INDE_DIR	0.050	3.290***
FEM_DIR	-0.040	-0.900
RAC_DIV	0.025	0.960
LEV_CEO_DUAL	0.152	3.370***
LEV_B_SIZE	0.112	0.970
LEV_INDE_DIR	-0.386	-3.350***
LEV_FEM_DIR	0.114	0.680
LEV_RAC_DIV	-0.267	-2.760**
TOTAL_ASSETS	-0.004	-1.380
TOTAL_SALES	0.024	10.510***
FIRM_AGE	-0.000	-0.390
LABOUR_SIZE	-0.020	-7.580***
LABOUR_INTENSITY	3.392	7.280***
Constant	-0.089	-1.900*
R-squared		0.31
Prob > F		0.000
N		300

Beta coefficient and significant at (* $p < 0.10$), (** $p < 0.05$), (***) $p < 0.01$)

DISCUSSION

Despite showing a negative relationship between leverage and financial performance, the result for hypothesis H_1 is not statistically significant, hence hypothesis H_1 is not supported. Although the result does not suggest a new contribution to the theoretical presumption, it indicates that there could be multi-faceted layers of managers' interactions and interventions by the board in managing debt, which could lessen the significance of the impact to the companies' financial performance. Hence, whilst our results do not provide support for Public Choice Theory to explain the motivation of managers in monitoring the level of debt in GLCs, it offers valuable insight that the leverage management in GLCs could encompass various other factors that may ultimately impact the financial performance.

Hypothesis H_{2a} shows that CEO duality is a significant moderator in exacerbating the negative relationship between leverage and financial performance, which is in line with the findings in Veprauskaitė and Adams (2013). This also corresponds with the guidance prescribed by the Malaysian Code of Corporate Governance which emphasized the importance of separating the duties between the chairman and the CEO. Essentially, the result amplifies the impetus of good governance through distinct and clear segregation of duties at the strategic management level to curb excessive exercise of power.

The effectiveness of good governance is also notable through the results of hypothesis H_{2c} , which shows that a higher proportion of independent directors is found to weaken the negative association between leverage and financial performance. This result is consistent with the findings by Masulis and Mobbs (2014), who found that independent directors positively impact a company's financial performance. This indicates that independent directors play an effective role in accentuating the capital management practices of GLCs, which is also in line with the spirit of good governance outlined by the Malaysian Code of Corporate Governance. Our results support the principal presumptions in Agency Theory, which calls for governance mechanisms to monitor the actions of the managers, principally through the separation of duties and the role played by the independent directors.

In an effort to strengthen the governance mechanisms, it is essential that the board comprises of members with diversified experience, expertise and skills, as prescribed by the Malaysian Code of Corporate Governance. Although the Code does not provide further details on the specific attributes that contributes towards "diversity", previous research report that diversity in terms of gender and ethnicity is found to be significant in improving a company's financial performance. In this regard, the result of hypothesis H_{2c} confirms this presumption, since ethnic diversity of board members is found to significantly weaken the negative relationship between the leverage

and financial performance. Ethnically diverse directors bring unique information to the firm, provide legitimacy and access to important constituencies in the firm's external environment (Carter et al. 2010).

Meanwhile, hypothesis H_{2b} , which examines the moderating impact of board size on the negative relationship between leverage and financial performance, is not supported. This implies that to effectively monitor the conduct of managers, the size of the board is less effective in comparison to the presence of independent directors. Accordingly, this suggests that independent directors are better able to challenge the viewpoints of the board, as opposed to merely having a large board size. In addition, hypothesis H_{2d} regarding gender diversity of the board, is not supported. The findings of hypothesis H_{2d} suggest that female representation on the board does not lead to effective monitoring of the board, compared to the ethnically diverse members of the board. Therefore, this implies that in the context of GLCs, ethnic diversity rather than gender diversity, is better able to effectively challenge the decision and conduct of the board.

In summary, adoption of the three theories in this study; namely the Public Choice Theory, Agency Theory and Human Capital Theory, fits the framework of a "hybrid" organization as suggested in the literature. Rather than competing with Public Choice Theory as the main guiding theory, these two theories support and amplify the need for good governance through the role played by the board. Our results enrich the notion that effectiveness of the board does not solely depend on the implementation of good governance practices. Instead, the richness of personal attributes offered by the diversity of the board, in particular ethnic origin, is able to provide competing viewpoints that the board could effectively benefit from.

CONCLUSION

Given the importance of Government Linked Companies (GLCs) and Government Linked Investment Companies (GLICs) in the Malaysian economy, our study provides recent insights on the impact of corporate governance variables on the financial performance of these companies. The key findings of our study are that separation of duties and directors' independence are important mechanisms towards effective monitoring in the context of GLCs. Accordingly, this provides evidence that despite the inherent criticisms, the GLC transformation initiated by the government led towards better corporate governance in GLCs. Moreover, our results also show the importance of racial diversity on corporate boards, which is supported by the Human Capital Theory and conforms with the spirit of diversity as explicitly prescribed by the Malaysian Code of Corporate Governance. In this regard, the presence of independent directors and ethnic diversity effectively weaken the negative relationship between leverage and financial performance, which implies better

capital management. Adopting the perspective of a "hybrid" organization which brings to the application of Public Choice Theory does not however, yield compelling results due to its statistical non-significance between leverage and financial performance. Nevertheless, our results amplify the importance of the richness in personal attributes ascribed by differences in ethnic diversity in accentuating the governance mechanisms.

This study extends Ayaz et al. (2021) by examining the link between financial leverage on firm profitability in the context of GLCs. Additionally, this study also includes corporate governance as a moderator variable as prior studies have argued that deviation from a target capital is related to the quality of corporate governance (Miloud 2022). This study has several practical implications to policy makers and regulators. The findings are expected to provide current evidence to Securities Commission Malaysia and Bursa Malaysia on the importance of effective corporate governance in GLCs. Moreover, this study has important implications for corporate governance's role in the link between capital structure and firm performance in GLCs. First, in the relationship between capital structure and company performance, the quality of the governance system is a key aspect. In particular, when non-duality and independent directors are present, the board of directors or management makes better capital structure decisions, which can lead to improved firm performance. Second, this study provides preliminary empirical evidence on the importance of board diversity on the relationship between capital structure and firm performance. Consequently, the management of GLCs should work towards diversity in their corporate boards. Although this study makes an important contribution by providing insights on corporate governance in Malaysian GLCs, it has a number of inherent limitations. Specifically, our sample consists of only 20 GLCs and hence, our results should be interpreted with caution. Nevertheless, our findings shed some light on understanding the moderating impact of corporate governance mechanisms on the relationship between leverage and financial performance of GLCs.

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APPENDIX

List of 20 Government-Linked Companies (GLCs)

1. Affin Holdings Berhad
2. Axiata Group Berhad
3. BIMB Holdings Berhad
4. Boustead Holdings Berhad
5. Chemical Company of Malaysia
6. CIMB Group Holdings Berhad
7. Golden Hope Plantations
8. Malaysia Airports Holdings
9. Malaysia Building Society
10. Malaysian Airline System Berhad
11. Malaysian Resources Corporation
12. Malayan Banking Berhad
13. POS Malaysia Berhad
14. Proton Holdings Berhad
15. Sime Darby Group Holdings
16. Telekom Malaysia
17. Tenaga Nasional Berhad
18. TH Plantations Berhad
19. UEM Group Berhad
20. UMW Holdings Berhad