

## Chapter 13

# Investigating the Relationship of Corporate Cash Holdings, Corporate Governance, and Firm Performance in Malaysia

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### ABSTRACT

*Current practice shows that firms throughout the world are in favor of high cash holdings; yet, they are still performing well. This situation contradicts the agency and free cash flow theories, which suggest that excessive cash may increase agency costs and lower firm performance. The purpose of this study is to examine the relationship between corporate governance, cash holdings, and firm performance. Five thousand four hundred twenty observations were conducted, and a balanced panel data analysis was performed. The results indicate that corporate governance has a significant impact on cash holdings, corporate governance has a significant impact on firm performance, and cash holding has a significant impact on a firm's performance. The findings of this study do not show any evidence to support the agency and free cash flow theories among non-financial Malaysian firms listed on Bursa Malaysia. Thus, this study contributes to the finance and accounting literature by gaining a better understanding of firm performance indicators in Malaysia, specifically.*

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## **INTRODUCTION**

According to CNN Money (2015), Apple Inc., one of the most valuable and successful companies in the world, had kept \$203 billion in cash in 2015. This was a rise in value from \$178 billion in 2014, making it the first firm in the world to ever cross \$200 billion in cash reserves. Besides, in the 2015 Moody's Investors Service report, Apple was reported to have raised its cash reserves by \$138 billion since 2009. All these figures show the significance of cash reserves (also known as cash holdings) to the profitability and success of a firm. This new trend of cash holdings, however, cannot be explained by conventional theories. From the agency theory perspective, high cash holdings will lead to the deterioration of firm performance (Al-Najjar and Clark, 2017; Abid and Lodhi, 2015; Jensen, 1986; Jensen and Meckling, 1979).

Cash holding is one of the essential means to control the agency issue and can be employed as a substitute for corporate governance to mitigate agency conflict (Mikkelsen and Partch, 2003; Opler et al., 1999). In Asia, corporate governance has been a concern and is often regarded as a weak link in firm performance (Zabri et al., 2016; Tam and Tan, 2007; Singham, 2003). Since the inception of agency theory by Jensen and Meckling (1979) and Jensen (1986), quite a several studies have investigated the relationship between corporate governance, cash holding, and firm performance. However, these studies failed to examine the combination of these parameters altogether. Most of the previous research fell short on assessing the relationship between crucial explanatory variables of corporate governance and cash holdings (Alves and Pinho, 2012; Bansal and Sharma, 2016; Bigelli and Sánchez-Vidal, 2012; Bruynseels et al., 2016; Chen and Chuang, 2009; Dittmar and Mahrt-Smith, 2007; Kuan et al., 2011; Kusnadi, 2011).

Furthermore, the association between the board of directors' and the chairman's expertise with firm performance has not been thoroughly investigated. In addition, studies on this topic reported contradictory results, were limited to small sample sizes, and have been identified as not having enough experimental variables to represent the corporate governance, economic environment, political and regulatory systems of countries together with the corporate governance mechanisms, business risk and nature of industries (Bruinshoofd and de Haan, 2005; Chen, 2008; Ittner et al., 2003). In this study, the missing part of this puzzle is addressed. The economic environment is controlled by choosing samples from a homogenous dataset at a stable range of time within one country. Although similar studies have been conducted within the same context (e.g., Kusnadi, 2011; Zabri et al., 2016), most of them employed a limited number of observations. This study thus provides comprehensive evidence on the relationship between corporate cash holding, corporate governance, and firm performance.

## **LITERATURE REVIEW**

### **Malaysian Code on Corporate Governance**

Malaysian Code on Corporate Governance (MCCG) introduced in 2000 is comprised of a set of best practices anchored on accountability and transparency aimed to strengthen the corporate culture (Securities Commission of Malaysia, 2017). The introduction of MCCG is also aimed to promote ethical behavior, improve accountability and transparency, develop sustainability, eliminate inefficiency, and abolish corporate fraud among Malaysian firms. To ensure that the MCCG remains relevant and is aligned with globally-recognized best practices and standards, it is reviewed periodically by a group of experts.

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