

THE IMPACT OF CORPORATE GOVERNANCE CHARACTERISTICS ON MALAYSIAN FIRM PERFORMANCE

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Abstract. With the rise of 982 public listed companies, the highest since 2008, this research helps suggest to corporations in Malaysia to reflect on the importance of having a transparent and constructive standard of corporate governance. This research focuses on the significant impact of non-financial factors which include the number of independent directors, gender diversification, and board size and its impact on a company's financial performance in Malaysia. In effort to avoid conflict and bias within the organization, the Securities Commission of Malaysia has implemented the Code of Corporate Governance 2021, Section 5.2, that requires at least half of the board members comprised of independent directors. Good governance also includes diversification. In an article from the Straits Times, Finance Minister of Malaysia stated that companies with large capital in Malaysia will mandate one women director. Followed by the board size, based on recent research from Harvard Law School Forum, the size or number of the board of directors does have an impact on firm performance. Results showed that the three independent variables which include board size, board independence, and board gender diversification all have a positive significant correlation to the overall financial performance of their companies. This research will leverage on secondary data collection, regression, correlation analysis and descriptive statistics.

Keywords: *impact, corporate governance, firm performance, board of directors*

Introduction

Based on the neoclassical economic theory “Profit Maximization”, it is a famous concept that firms use in the process of decision-making, pricing strategies, and producing output. The concept operates by two principles which are to maximize profit and minimize costs (Brueckner, 2013). However, as the world evolves and businesses arise, the United Nations (UN) has become aware that some businesses operate unethically and therefore created a movement called Economic, Social and Corporate Governance (ESG). This ESG movement focuses on the non-financial aspects of a business which is the corporate responsibility towards the environment, the internal and external social relationship between stakeholders, and corporate governance. In the United States, the S&P 500 which contains the 500 largest companies listed on the stock exchange has now published its ESG report as a part of its annual report and made it mandatory in certain jurisdictions (Pérez et al., 2022). The idea of corporate governance came into light after the infamous case in America in 2001. The case of Enron Corporation and audit firm Arthur Andersen. This scandal has caused the largest bankruptcy and has led to policy changes. While in Malaysia, the financial crisis in 1997 has prompted to many new policies and one of them was regarding corporate governance. In the year 2000, the Malaysian Code on Corporate Governance (MCCG) was introduced and has been positively beneficial. This policy was created to help

standardize Malaysian companies to be universally accepted by following global practices of corporate governance which is not required by statute, regulations or those prescribed by Bursa Malaysia. Due to corporate governance, many theories arise such as agency theory, stakeholder theory, stewardship theory and resource dependency theory. This has resulted that a good corporate governance is necessary in order to achieve organization wealth. Overall, this research consists of analyzing the relationship between the independent variable which are corporate governance characteristics of a company with the dependent variable which is public listed companies' performance in Malaysia. As for the corporate governance characteristics, we would namely focus on how diversification is vital whilst also looking at the size or number of board of directors in an organization that impacts the companies' financial performance. Moreover, this chapter also consist the research background, problem statement, research question, objective, and the aim of this research study.

Literature review

Board independence and firm performance

The conflict-of-interest issue can be addressed through the Enron scandal. In 2001, America was hit with the infamous case named Enron scandal. The scandal calls for the largest bankruptcy and immense audit failure. A study determined that Enron had overlooked its management which led to a conflict of interest and absence from board independence (Li, 2010). Consequently, this catastrophe has led to a new strategy or approach towards corporate governance. Indirectly, many companies are asked to comply with this new policy. As for Malaysia, the Securities Commission has implemented in the Malaysia Code of Corporate Governance 2021, section 5.2, that requires at least half of the board members comprised of independent directors. As stated by the Wall Street Journal, in the United States, independent directors are made up of 66% of all boards and 72% percent of Standard & Poor's 500. Even though there is much research on the importance of Board of Director independence with the firm's earnings, the results are mixed. Based on research done Cerbioni and Parbonetti (2007), there is a negative relationship between the independence of board committees and capital disclosure, Bhagat and Black (2001) also find no significant relation between board independence and firm performance. Similarly, previous study found out no relation between firm performance and the proportion of outside directors. A study in Malaysia also indicates that board and audit committee independence does not increase the shareholder's earnings or profitability (Johari et al., 2009). Despite this, a study in India indicates that companies with more than 50 percent of independent director in place result in higher firm performance (Soni and Singh, 2020). Moreover, independent director still contributes to other features of an organization such as reporting, and social responsibility (Soni and Arora, 2016). A study in Hong Kong also indicates a significant relationship between board independence and firm performance (Leung et al., 2014). Overall, this research will provide insight into the relationship based on Malaysia companies' market.

Gender diversification and firm performance

Women in board is important for several reasons and one being diversity. A study in United States indicate that due to higher education qualification and control over purchasing power, women tend to be better in managerial roles. In a study by Kemp

(2020), also state that women grant six times of innovation and twice of good financial targets. Moreover, in the Italian market indicates that the presence of women on board improves financial profits. Another research states that due to societal gender differences, investors are more influence in the future earning potential of a firm (Post and Byron, 2015). Another research states that women directors tend to show consideration in stakeholders' interests and they are twice more likely to hold a doctoral degree (Hillman et al., 2002). Another study by Arayssi et al. (2016) indicate that participation of women on board improves the company social consciousness and increases the firm welfare. Some suggested that women on board tend to be more sensitive relating to sustainability affairs (Bear et al., 2010). In fact, in 1990, research resulted that women are inclined to adopt a more democratic style of leadership and less autocratic, while men are prone to follow a directive style (Eagly and Johnson, 1990). As previous study states, women are perceived to be more caring and independent whilst men are more assertive and self-reliant. By having a democratic leader, the organization would become a more involve team members in the decision-making, exchanging perspective and valuing each member input. This will enhance a more collaborative and foster a sense of inclusivity within the team. Alternatively, due to the low representation of women, some research failed to show any relationship between the board gender and firm performance. As stated by Marashdeh et al. (2021), the female board only consists of 3.63% of the 77 companies in Jordan. Undeniable, these are due to the culture indifferences and the stereotype that women are supposed to perform wifely duties while men compete in the workplace led to differences in gender socialization that encouraged men and women to behave like "the opposite sex" (Rudman and Phelan, 2008). Based on this research we are going to allocate this relationship within the Malaysian firms.

Board size and firm performance

The crucial part of an organization is to determine the size of the board of directors. As for Malaysia, the Malaysia Code of Corporate Governance has never stated the required number of directors needed in a company, and most policymakers and regulators discourage massive boards of directors in many countries. There are also contradicting result as for the empirical studies. On one side a study showed that a certain market i.e., a property firm prefer a small board with fewer numbers, consisting of an average of 7 directors from outside directors but with more executive working directors (Shakir, 2008). Another finding stated that there is positive relationship between the board size and firm profitability in Malaysia. It seems that the market prefers larger board as it provide more connection and information in the business (Ghasemi and Ab Razak, 2016). A study by Pucheta-Martínez and Gallego-Álvarez (2020) has also found the same result which covers 34 different countries and 10,314 firms. Another study by Alqatan et al. (2019) was done in the United Kingdom and came with the same result. On the other side, a study by Yermack (1996), he found that there is a negative relationship between board of directors' size and firm performance. In Egypt, a study was conducted by Elsayed (2011) and found that board size and corporate performance have a negative relationship. In Germany, there is evidence that by imposing a large board size results in low firm performance and values (Jenter et al., 2023). In Canada, a study for manufacturing firms also indicates the same result as in Germany (Gill and Mathur, 2011). Based on this research we are going to allocate the relationship within the Malaysian firms.

Theoretical framework and hypothesis

The theoretical framework can be shown in *Figure 1*. The hypothesis are include:

H1: There is a positive significant impact between board independence and the firm performance of publicly listed companies in Malaysia.

H2: There is a positive significant impact between the board diversification and the firm performance of publicly listed companies in Malaysia.

H3: There is a positive impact between board size and the firm performance of publicly listed companies in Malaysia.

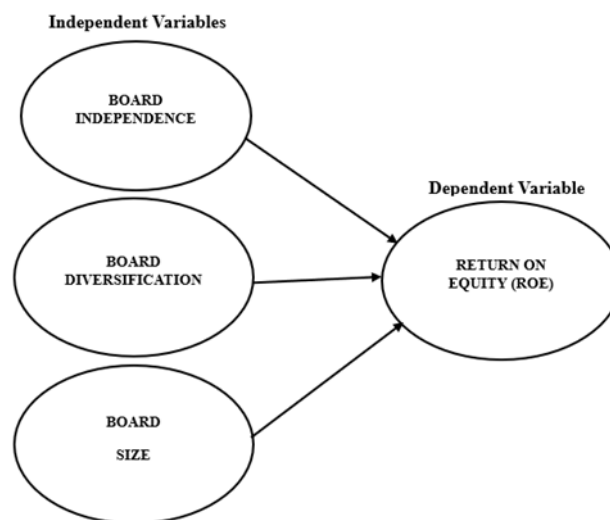


Figure 1. Theoretical framework.

Agency theory and firm performance

This theory focuses on the contractual relationship between the shareholders and management. Based on previous study, the agency relationship is a contract under which one party (the principal) elect another party (the agent) to perform a service or an act on behalf of them. There are many critics regarding this theory as the agent and principal do not always align with each other. The model states that the agent is individualistic and often associated with a conflict of interest for personal gain. Based on this theory, the agency would be the board of directors while the principal would be the shareholders. The board of director are then responsible to ratify the decision made by managers and would need to clarify the decision made. This relationship has been examined by several economist who emphasize on separation of ownership and control, corporate governance and the board of directors, the composition of board of directors and strategic control. Based on *Figure 2*, the issue raises as the shareholders focus on increasing their company's wealth while the management are focuses on their compensation instead. Thus, creating a conflict. However, the 'father of economics', Adam Smith made a contradicting opinion as he stated that a successful manager will not endeavor into autocratic leadership which means a management process driven by a business' upper level of executives, but instead demonstrate an appropriate structure which align workers and firm interest.

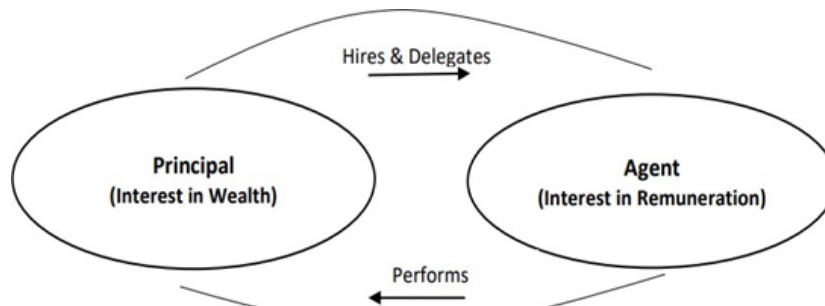


Figure 2. Agency theory model.
Source: Yusoff and Alhaji (2012).

Stewardship theory and firm performance

The following theory is called Stewardship Theory. Developed by Donaldson and Davis (1993), this theory was created to counterpoise the agency theory. Differs from the agency theory, this theory focuses more on understanding the manager's motivation which is set by steward goals instead of individualistic. This theory believes there is no conflict of interest between the principals and agents and that the pair works effectively to achieve their goals. Moreover, since the agent or manager has executive control in an organization, this theory believes that they are amiable in their actions. Despite the difference, both theories are similar in the sense that both embark into the sociology and psychology aspects of behavior and governance. It reflects a more human-centered model rather than the economic view of the agency theory. In summary, the difference between these two theories can be discerned from *Table 1*.

Table 1. Comparison of agency theory and stewardship theory.

Category	Agency theory	Stewardship theory
Model of man	Economic man	Self-actualizing man
Behaviour	Self-serving	Collective serving
Psychological mechanisms		
Motivation	Lower order/economic needs (psychological, security, economic)	Higher order needs (growth, achievement, self-actualization)
Social comparison	Other managers	Principal
Identification	Low value commitment	High value commitment
Power	Institutional (legitimate, coercive, reward)	Personal (expert, referent)
Situational mechanisms		
Management philosophy	Control oriented	Involvement oriented
Risk orientation	Control mechanisms	Trust
Time frame	Short term	Long term
Objective	Cost control	Performance enhancement
Cultural differences	Individualism; high power distance	Collectivism; low power distance

Materials and Methods

For the purpose of this research, the data collection method chosen is the secondary data method. The secondary data method can be defined as a set of data or information assembled available and published sources. This data is then collected through published Annual Reports from Bursa Malaysia form the year 2019 until 2023 and consists of fifty different firms from different industries, backgrounds, and expertise. As of July 2024, the number of public listed companies increase to 982, the highest since 2008 (Salim, 2022). As suggested by Krejcie and Morgan (1970), if the population size consists of roughly 1000, the sample size that we need to choose from are a total of 278

(Table 2). Furthermore, the study also suggested the number and range that is required for research (Table 2). However, due to time constrain, we would only choose 50 companies from various industries that is listed in Bursa Malaysia and later calculate the financial performance of the selected companies from 2019 up to 2023. This will sum up a total of 250 sample sizes.

Table 2. The selected industries and number of companies.

Industries	Number of companies
Manufacturing	5
Food and Beverages	5
Property	5
Private healthcare	5
Technology	5
Transportation and Logistic	5
Plantation	5
Construction	5
Utilities	5
Telecommunication and Media	5
Total	50

To define, multiple linear regressions are a study of multiple variables relationships. It involves two variations such as the independent variable and dependent variables (Bobbitt, 2020). There are several benefits to using this analysis which include predicting the dependent variable based on the independent variables. From there it may also show the significance between these variants as it may influence each other (Mehta, 2023). The drawback of this model is that it may be falsely concluded or correlated due to misstatement of data (Weedmark, 2018). Furthermore, according to Uyanık and Güler (2013), the multiple regression can be formulated into (Eq. (1):

$$ROE_i = \beta_0 + \beta_1 BSIZE + \beta_2 BIND + \beta_3 BGEN \quad \text{Eq. (1)}$$

Where, ROE_i=Net income/Total Equity, BSIZE=Total number of Board of director, BIND=Total number of independent directors, BGEN=Total number of women directors.

Results and Discussion

Table 3 generated the financial measurement such as return on equity (ROE) used in this research, provided that the lowest value was -0.822 and the maximum value of 2.171. As the formula for this ratio is net income divided by total equity, these numbers show the result of the management's success in maximizing the return on the owner's investment. While the standard deviation of the ROE is 0.266. Based on Table 4, there is a fluctuation in the standard deviation for ROE as the highest being 0.334 in 2019 while the lowest being 0.115 in 2022. Furthermore, over the five years from 2019 to 2023, the minimum ROE was in 2022 with -0.101 and the highest in 2020 with 2.015. In detail, this analysis provides an insight into the mean of our data. As computed, with a 250-sample size, which consists of 50 public listed companies from Bursa Malaysia, the average mean for the board size is 8 (rounded off from 7.82). This just determines

that there is a weak relationship between the Board size and the company's performance as stated by Elsayed (2011) and Yermack (1996).

Table 3. Descriptive statistics (N=250).

Category	Minimum	Maximum	Mean	Std. Dev.
ROE	-.822	2.171	.11652	.266510
Board size	3	13	7.82	2.291
Board Independence	1	6	3.50	1.406
Board Gender Diversification	1	5	2.36	1.248

Table 4. Breakdown of descriptive statistics (N=50).

Year	Category	Minimum	Maximum	Mean	Std. Dev.
2019	ROE	-.332	2.171	.12408	.334392
	Board size	3	13	7.82	2.310
	Board Independence	1	6	3.50	1.418
	Board Gender Diversification	1	5	2.36	1.258
2020	ROE	-.497	2.015	.12402	.329299
	Board size	3	13	7.82	2.310
	Board Independence	1	6	3.50	1.418
	Board Gender Diversification	1	5	2.36	1.258
2021	ROE	-.374	1.836	.16282	.308477
	Board size	3	13	7.82	2.310
	Board Independence	1	6	3.50	1.418
	Board Gender Diversification	1	5	2.36	1.258
2022	ROE	-.101	.455	.11026	.115653
	Board size	3	13	7.82	2.310
	Board Independence	1	6	3.50	1.418
	Board Gender Diversification	1	5	2.36	1.258
2023	ROE	-.822	.377	.06141	.163413
	Board size	3	13	7.82	2.310
	Board Independence	1	6	3.50	1.418
	Board Gender Diversification	1	5	2.36	1.258

Based on *Table 4*, the Board independence, out of the 8 in total board size, there are at least 4 (rounded off from 3.5) of independent directors. To sum up, there is only an average of 57.14%. Meaning, that the 50 selected companies from Bursa Malaysia comply with the Malaysian Code of Corporate Governance 2021, Section 5.2, which requires at least half of the board members comprised of independent directors. However, this shows that there is a weak relationship between board independence and the company's performance as stated by Cerbioni and Parbonetti (2007) as well as Bhagat and Black (2001), followed by the study on Malaysian companies from Johari et al. (2009). Lastly, this part covers the Board gender diversification. Out of the 8 in board size, an average of only 2 (rounded off from 2.36) are listed as women on board. To sum up, there is only an average of 28.57% of women on the board of directors using the given sample size. This indicate that there is a weak relationship between the number of women in board and the company's performance. Hence, this just proves the study by Marshdeh et al. (2021) that due to the low representation of women, the research to study the correlation between these two variables might fail. Based on *Table 5*, the result indicates a positive relationship between the ROE with board size and gender diversification. As the correlation coefficient for board size is 0.043 and gender diversification is 0.102. However, there is a negative relationship between ROE and board independence as the correlation coefficient is -0.026. For interpretation, Schober et al. (2018) stated that a result of ± 0.00 to ± 0.10 is considered negligible correlation while ± 0.10 to ± 0.39 is considered as weak correlation. Hence, both result of 0.043 and 0.102 would consider as negligible correlation. This mean that a change of both number

of board size and board gender has no influence on the company’s performance. As for board independence, a result of -0.026 would indicate no correlation and relationship between these variables. Furthermore, the p-significance relationship (2-tailed), indicate no significance relationship for all three variables as all the result are more than 0.05 ($p > 0.05$). As stated above, the result for board size is 0.503, gender diversification 0.106, and lastly board independence 0.687.

Table 5. Pearson correlation analysis.

Category		ROE	Board size	Board independence	Gender diversification
ROE	Pearson	1	.043	-.026	.102
	Correlation Sig. (2-tailed)	-	.503	.687	.106
Board size	Pearson	.043	1	.464**	.402**
	Correlation Sig. (2-tailed)	.503	-	<.001	<.001
Board independence	Pearson	-.026	.464**	1	.435**
	Correlation Sig. (2-tailed)	.687	<.001	-	<.001
Board gender diversification	Pearson	.102	.402**	.435**	1
	Correlation Sig. (2-tailed)	.106	<.001	<.001	-

Table 6 indicates that the R-Square (R^2) is 0.017, which translates to a 1.70% of change in the dependent variables, ROE. This shows that the company’s performance, expressed through Return on Equity (ROE), may not be used to approximate the board size, independence, and gender composition. Additionally, it could mean that the dependent variable or ROE is not a significant variable to indicate the relationship with the independent variables (Table 7). Despite this, the balance of 98.3% of other factors would cause a change in ROE. This analysis has also affirmed the chosen variable as R Square (R^2) is a result of the coefficient of confidence. The 0.006 or 0.6% value of adjusted indicate that it is low reliable in generating ROE variation, in return, making the standard error of estimation 0.2658%. Based on Table 8, it indicates that the all three variables have a significance positive result with the firm performance. This is because, if the p-value of the hypothesis is more than $\alpha = 0.05$, we will accept the hypothesis. Hence, with the result of 0.627 for board size, 0.187 for board independence and board gender diversification 0.072, we would overall accept the hypothesis. For measurement, an increase of one unit in the board size, the ROE will increase by 0.004. While, an increase of one unit in the board independence, the ROE will increase by 0.019 and lastly, an increase of one unit in the board gender diversification, the ROE will increase by 0.028.

Table 6. Regression analysis.

Model	R	R^2	Adjusted R^2	Std. Error of the estimate
1	.132 ^a	.017	.006	.2658

Table 7. Breakdown of regression analysis.

Year	R	R^2	Adjusted R^2	Std. Error of the estimate
2019	.120	.014	-.050	.342624
2020	.159	.025	-.038	.335540
2021	.252	.063	.002	.308143

2022	.291	.085	.025	.114193
2023	.158	.025	-.039	.166548

Table 8. Breakdown of regression analysis.

Category	Unstandardized coefficients		Standardized coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.084	.062	-	1.338	.182
Board size	.004	.009	.036	.487	.627
Board Independence	.019	.014	.099	1.324	.187
Board Gender Diversification	.028	.015	.131	1.808	.072

Conclusion

The purpose of this study is to enhance a better understanding of one of the elements of Environment, Social, and Corporate Governance (ESG). Specifically, our understanding of the corporate governance relationship with financial performance. The finding has resulted in significance positive correlation between all three variables with company financial performance. Firstly, there is a positive and significant relationship between the board's independence and the company's performance. This would prove the study by Soni and Arora (2020; 2016) that was made in India's companies' market. Moreover, the study by Leung et al. (2014) was also conducted in Hong Kong and indicated the same results. Secondly, by imposing gender diversification also resulted in a significance result of company's performance. This prove that gender diversification is vital and proves the study by Post and Byron (2015) that determine the positive relationship these two factors have. Some studies have stated the reason for this positive relationship is due to women's characteristics. As Hillman et al. (2002) state that women tend to be more considerate of stakeholders' interests, Arayssi et al. (2016) state that women provide better social consciousness, Bear et al. (2010) state that women are more sensitive to sustainable affairs. A study by Eagly and Johnson (1990) states that women are more democratic, independent, and self-reliant. Finally, although the Malaysia Code of Corporate Governance has no requirement for the number of board members for companies in Malaysia, this research prove that the average board size of 50 publicly listed companies in Malaysia is 7.82 or 8 people. Hence, this would prove the study of Shakir (2008) that states most firms require an average of 7 directors. A study by Ghasemi and Razak (2016) has stated that a large board provides more information towards the company. While Pucheta-Martínez and Gallego-Álvarez (2020) as well as Alqatan et al. (2019) has also attained the same positive results.

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Conflict of interest

The authors confirm that there is no conflict of interest involved with any parties in this research study.

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