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Corporate governance, HRM practices and organizational performance

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Abstract: This study is unique as it analyzes corporate governance concept from a stakeholders' perspective, instead of the more dominant shareholders' perspective as indicated in previous studies. The study attempts to bridge the gap in the existing literature by examining the link between corporate governance, HRM practices and organizational performance. Attempt is also made to include the role of HRM as a mediator in explaining the relationship between corporate governance practices and firm performance. Data were collected from public listed companies in the consumer product sector in Malaysia. Using multiple regression analysis, the significance of the relationship between HRM practices and organizational performance is observed thus provides the evidence that HRM plays an important role for companies and this parallels previous studies. The result also implies that there is a link between corporate governance practices implemented in companies and the types of HRM practices implemented. Most importantly, the findings of the study reveal that the stakeholder approach is a viable approach to be taken in studying corporate governance. Despite the difficulties in gaining co-operation and responses from the companies involved, it proves that the stakeholders specifically the employees are aware of the issue of corporate governance and the companies are required to raise and maintain their standards.

Keywords: corporate governance, human resource management, organizational performance.

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1. Introduction

1.1. Background of study

The study of corporate governance has grown rapidly during this last decade, prompted by the crises associated with Enron, WorldCom, Parmalat and other corporate scandals. The list was extended more recently resulted from the economic recession among major world economies, associated with the high risk lending in America to sub-prime borrowers which saw the subsequent collapse of credit and the demise of some of the world's largest financial institutions (Ferguson and Kang, 2008). In Malaysia, cases like MAS and Perwaja hogged the headlines, highlighting the failure of corporate governance practices implementation.

In a developing country such as Malaysia, good governance is crucial for economic survival. The Asian economic crisis in 1997-1998 and the recent global economic downturn in 2009-2010 have proven that despite sound economic fundamentals, Malaysia was not spared from the economic meltdown. The crises demonstrated the need for better corporate practices. Gross failure of a number of businesses in the onslaught of both economic crises has highlighted the failures and incompetence in the implementation corporate governance practices. Thus, there is a need to understand the quality, i.e. the extent, of the corporate governance practices employed by the firms.

Although numerous studies have been conducted to examine the various issues involving corporate governance, hardly any of them focus on the relationship between corporate governance and HRM. Prior literature in Malaysian context focuses more on studying the relationship between corporate governance mechanisms and corporate performance (e.g. Rashidah and Roszaini, 2005; Rashidah and Fairuzana, 2006), corporate governance code or corporate law reform e.g. Ow-Yong and Guan (2000) and Hee (2003) and impact of culture, corporate governance and disclosure on corporate reporting (Haniffa and Cooke, 2002a; Haniffa and Cooke, 2005b). The gap that this study wishes to address is the influence of corporate governance practices on HRM and how such relationship has an impact on organizational performance. The current study is attempted to reveal the effect of HRM practices as a mediator between corporate governance and organizational performance. Thus, the study intends to focus on the interaction between corporate governance practices and HRM practices of organizations.

This study is unique as it analyzes corporate governance concept from a stakeholders' perspective, instead of the more dominant shareholders' perspective as indicated in previous studies. Stakeholders' perspective is a recent phenomenon, where, researchers recognized that the accountability of a company does not extend merely to its' shareholders but rather to a wider audience. According to Caldwell, Karri, & Vollmar (2006), the evolution of governance models, presented by stakeholder theory extends the company's obligations beyond shareholders interest and this is based on the assumption that the company has responsibilities to its employees, the public and a variety of ethical and moral obligations to other interested parties. The role of leadership in human resource in the governance of the organizations has received increased attention in the post-Enron era (Caldwell, Hayes, Karri, & Bernal, 2008; Hernández, 2005). Caldwell, Truong, Linh, and Tuan (2010) described the CEOs, as leaders who have a complex set of obligations to stakeholders. These obligations generate long-term wealth to achieve the benefits of all stakeholders and highlight the obligations of the company with society. Supangco (2006) mentioned that successful human resource practices in organizational capacity building help the organization to adapt to changes in a global environment; these practices provide the necessary infrastructure to enable the organization to create value in the market. Considering human capital as part of unique and valuable knowledge of the employees, they will be relevant features to generate a sustainable competitive advantage. Corporate governance role in ensuring good employment practice and effective management of human capital is that this is both an end in itself in ensuring the well-being and satisfaction of employees but also a means to an end of a higher performance (Guest, 2005). The argument is strengthened by Lamba and Choudary (2013) that good HR practices enhance internal capabilities of an organization to deal with current or future challenges. Apart from that, it also energize people working in the organization to be committed and motivated.

This study contributes a significant implication in view of the general scarcity of empirical studies in Malaysia concerning the interrelationship between corporate governance practices, HRM and its effect on organizational performance, as previous studies are mainly concentrated in the Western hemisphere. It is expected to yield additional insight regarding the extent of corporate governance practices adopted and implemented by the firms. It would also help forge a better understanding of the nature of corporate governance in Malaysia.

2. Literature review

2.1. Stakeholder theory

One argument against the strict agency theory is its narrowness, by identifying shareholders as the only interest group of a corporate entity necessitating further exploration. By expanding the spectrum of interested parties, the stakeholder theory stipulates that, a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951).

The stakeholder theory therefore appears to be better in explaining the role of corporate governance than the agency theory by highlighting the various constituents of a firm. Thus, creditors, customers, employees, banks, governments, and society are regarded as relevant stakeholders. In other words, firms are not merely bundles of assets that belong to shareholders, nor can they be in a modern world when the key assets are largely intangible and under the control of knowledgeable employees (Kay, 2004). Instead, governance structures and the work of senior managers are aimed at maximizing the total wealth of the organization for the benefits of those inside it that contribute firm-specific assets, i.e. their knowledge and skills, as well as those outside it. This theory fits in well with the assumptions of reputation management, which recognizes the importance of constituencies including customers, suppliers, employees, business partners, government, the press, investors and society at large (Martin and McGoldrick, 2009).

2.2. Corporate governance

The Asian financial crisis in 1997-1998 has proven the inefficiency of corporate governance and transparency (Ho and Wong, 2001). Therefore, the introduction of Malaysian Code on Corporate Governance (MCCG) in 2000 (revised in 2007) by Federal Committee on Corporate Governance (FCCG) is to observe and establish a sound corporate governance framework. The recommendations in the Code have become mandatory for all public listed companies to comply, effective from June 2001 (Mak and Li, 2001). The Code highlights the importance of strengthening corporate governance practices on public listed companies in Malaysia.

Governance is concerned with the direction and control of the corporation. The task of governance now includes the act of balancing the needs, goal and interests of different stakeholders (Supangco, 2006). The OECD defines corporate governance as a set of relationships between different corporate actors: management, board, shareholders and stakeholders. Tirole (2001) describes the essence of corporate governance from a shareholder view as how to ensure that managers, who decide for the benefits of shareholders, internalize the external effects of their decisions for the benefits of the shareholders. Similarly, Shleifer and Vishny ((1997) define it as the protection of the interests of shareholders. By contrast, Donovan (2003) describes corporate governance from a stakeholder perspective as a system of structuring, operating, and controlling a firm with a view to achieve long-term strategic goals to satisfy shareholders, employees, customers, creditors, suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs.

Corporate governance can be conceptualised as a set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled, and its purpose is to influence directly or indirectly the behaviour of the organisation towards its stakeholders (Dignam and Lowry, 2006). It is concerned with the duties and responsibilities of a company's board of directors to successfully lead the company, and their relationship with its shareholders and other stakeholder groups (Pass, 2004). The outcome of a good corporate governance practice requires an accountable board of directors who ensures that the investors' interests are not jeopardized (Hashanah and Mazlina, 2005). The accountability and transparency component of corporate governance would help companies gain shareholders' and investors' trust. These stakeholders need assurance that the company will be run both honestly and cleverly. This is where corporate governance is critical (Morck and Steier, 2005). Corporate governance improves stakeholders' confidence and this would aid the sustainability of business in the long run.

Various researches have been conducted to examine the effect of corporate governance mechanism (ownership structure, board composition, board and CEO ownership, CEO compensation and tenure) on company performance. In Asia, Chen et al (2005) analyzed 412 publicly listed firms in Hong Kong from 1995-1998 to examine whether corporate governance mechanisms (CEO duality, composition of BOD, audit committee). Haniffa and Hudaib (2006) utilized six corporate governance variables (board size, board composition, CEO duality, multiple directorship, ownership concentration and managerial shareholding) in their study.

2.3. Corporate governance and HRM

Corporate governance is essentially concerned with issues of ownership and control within the firm (Berle and Means, 1932). It sets the terms and conditions of the legal allocation of property rights among the different stakeholder groups; and this affects their incentives and hence their willingness to cooperate with one another in productive activities. Due to the diffusion of responsibility for production, process improvement and innovation has been shown to significantly improve organizational performance through the cooperation of stakeholders in the productive process and their voluntary contribution of skills, experience and commitment to meet organizational objectives, corporate governance plays a central role in the ability of firms to perform effectively over the long term (Baker, Gibbons and Murphy,1999; Black and Lynch, 1997; Huselid, 1995; Ichniowski, Shaw and Prennushi, 1995; Konzelmann,2003).

According to Martin and McGoldrick (2009), little has been written about HR and governance and only a small number of HR articles cite corporate governance in their keywords, though prominent HR theorists have recently called for ways of conceptualizing HRM from a governance perspective (Gospel and Pendelton,2005; Legge,2004; Sisson, 2007).Nevertheless, there have been a number of useful attempts to map out the links between governance and HRM (Boxall and Purcell, 2008), including those writing from an 'employee voice' perspective (Gollan and Wilkinson, 2007).

Konzelmann et al. (2006) state that the central purpose of HRM is enhancing performance and in turn HRM itself, is affected by the implementation of corporate governance practices. Therefore, the demands of the stakeholder could impact on the HRM practices developed and implemented. HRM practices is a set of distinct yet interrelated activities, functions, and processes aimed at attracting, developing, and maintaining a firm's human resources (Tangthong, Trimetsoontorn, and Rojniruntikul ,2014). Martin and McGoldrick (2009) and Konzelmann et al. (2006) identified two streams of HRM, the hard HRM and soft HRM to be the result of the extent of corporate governance practices implemented. 'Hard' and 'Soft' HRM, were terms introduced by (Storey,1987), hard HRM focused on the resources management aspects of HRM, most notably cost control and workforce flexibility to align them with shorter -term product demand variables, and the soft HRM focused on human aspects of HRM, including communication, motivation, engagement, learning and leadership (Martin and Hetrick, 2006). Konzelmann et al. (2006) outline four variables considered as soft and hard HRM, namely, employee consultation and incentive systems (soft HRM) and training and teamwork (hard HRM).

2.4. Corporate governance practices and firm performance

According to Black (2001), Klapper and Love (2003), Gompers, Ishii and Metrick (2003) and; Beiner and Schmidt (2005), corporate governance plays an important role in improving the performance of a firm and there is a direct relationship between the two in both developing and developed financial markets. Past studies indicated that good corporate governance enhances a firm's performance (Brickley, Coles and Terry, 1994; Brickley and James, 1987), Byrd and Hickman, 1992; Chung, Wright and Kedia, 2003; Hossain, Cahan and Adams, 2000). In spite of the generally accepted notion that effective corporate governance enhances firm performance, other studies have reported negative relationship between corporate governance and firm performance (Bathala and Rao,1995; Hutchinson, 2002) or have not found any relationship (Park, and Shin,2003; Prevost, Rao and Hossain; 2002, Singh and Davidson, 2003; Young, 2003). A study by Mitton (2002) based on a sample of 398 firms from South Korea, Malaysia, Indonesia, Philippines and Thailand, have found that the firm-level differences in variables are related to corporate governance has strong impact on firm performance during East Asian Crisis in 1997 and 1998. The results suggest that better price performance is associated with firms that have indicators of higher disclosure quality, higher outside ownership concentration and they are focused rather than diversified.

Bhagat and Black (2002) contributed this to the different instruments that have been used individually in studying the effects of corporate governance on firm performance. These instruments include board of directors, independent directors, board size, CEO, managers, efficient market, political regime, government, regulatory authority and judiciary (Bhagat and Bolton, 2008). Bhagat and Bolton (2008) recommend the use of a more comprehensive instrument which would include all corporate governance practices instead of a single measure of governance.

2.5. HRM and firm performance

Universalistic arguments are the simplest form of theoretical statement in the HRM literature because they imply that the relationship between an independent variable and dependent variable is universal across the population. Developing universalistic predictions requires two steps. First, important strategic HR practices must be identified. Second, arguments that relate these practices to organizational performance must be presented. The universal or "best practices" perspective implies a direct relationship between particular approaches to human resources and performance, and the contingency approach posits that an organization's strategic posture either augments or diminish the impact of HR practices on firm performance (Delery and Doty, 1996; Youndt et. al, 1996).

HRM practices affect organizational performance through their effect on employee development and behaviors. These practices determine the type of employees who are selected, the skills and motivation of the employees, and the opportunities and incentives they have to design new and better ways of doing their jobs (Moideenkutty, Al-Lamki, & Rama Murthy, 2011). The common theme in the past literature relates that effective management of human resources which is aligned with the business strategy could lead to better firm performance (Guthrie, 2001). In this sense, HRM practices have been proven to effective as a source of competitive advantage for the organization.

According to Akdere (2009) a HR system focused on quality management was directly related to multiple dimensions of organizational performance outcomes (i.e., intangible – employee satisfaction and customer satisfaction – and tangible – profit). Knowledge management and strategic management were found to be positively related to the financial performance of firms implementing quality management. Process management is found to be negatively related to employee satisfaction. General HR practices were positively related to both employee and customer satisfaction. Employee focus of the firms is also positively related to employee satisfaction. Employee satisfaction is also related to both customer satisfaction and financial performance while customer satisfaction is found to be positively related to employee satisfaction. A study by Al-Kaha, Al-Zubi,Al-Dmour, Al-Shurideh and Masa'adeh (2011) found that human resource policies are positively related to organizational performance. They concluded that the most important effect of human resource policy on organizational performance is the employees' participation in decision making, however, this policy is not widely implemented because cultural attitude that discourages employees' participation in decision making or because of the nature of certain jobs that seem to be critical, risky, and systematic.

From the abovementioned discussions, the theoretical framework for this research is formulated. Corporate governance practices are the independent variable, HRM is the mediating variable and organizational performance is the dependent variable. The proposed hypotheses are:

H1: Corporate governance practices are positively and significantly associated with HRM practices

H2: Corporate governance practices are positively associated with organizational performance

H3: HRM practices are positively associated with organizational performance

H4: HRM practices are significantly mediate the relationship between corporate governance practices and organizational performance.

3. Methodology

3.1. Sampling and data collection

Sample of study will be collected from public listed manufacturing firms listed under the consumer product sector in the Bursa Malaysia, as the MCCG is compulsory for public listed firms. Data will be collected via self-administered questionnaires. The survey instrument will be distributed in two versions: English and Malay. The Malay version will be back-translated to ensure consistency with the English version. Based on census sampling, questionnaires were distributed to 132 consumer products companies. With the help of the HR managers, a senior employee was selected to respond to the survey, this is to ensure compliance with the stakeholders' approach. Only 34, companies returned the survey. However, this is still consistent with the rule of thumb by Roscoe (1975) who said that sample size of more than 30 is appropriate for most research. In addition, it is also argued that sample size in multiple regression analysis should be several times (preferably ten times or more) as large as number of variables which this study complies with.

3.2. Measurement of variables

Corporate governance practices: The corporate governance practices utilized for this study is adopted from Sang and Il (2004) survey instrument that covers the elements stipulated by MCCG. The instruments are board independence, external directors' independence, transparency and access to information and effectiveness of audit committee.

Human resource management (HRM) practices: The HRM practices utilized for this study is adopted from Delery and Doty (1996) survey instrument, following Konzelmann et al. (2006) approach of using soft and hard HRM; the study groups workforce flexibility and employee participation as soft HRM and training and development and teamwork as hard HRM.

Organizational performance: Perceptual measures will be used to assess organizational performance rather than objective or secondary data. The items are profitability, sales growth, sales volume and market share. The measure for organizational performance is largely based on the works of Fynes, Voss and Búrca (2005), Homburg, Krohmer and Workman (2004) and Hooley and Greenley(2005) that support the use of perceptual measures of organizational performance. Past studies by Dess and Robinson (1984), Venkatraman and Ramanujam (1985) and Palmatier, Rajiv and Dhruv (2007) also confirm that perceptual measures have been shown to have a high correlation with objective financial performance measures. For the purpose of this study the measures are adapted from Panayides (2010).

3.3. Pilot test

Prior to carrying out the survey, a pilot test was conducted on 10 employees of a public company to test the usability and to refine the instrument.

4. Findings

Table 1 outline the descriptive analysis conducted on corporate governance practices. The table describes the perception of the respondents with regards to corporate governance practices implemented in the respective companies. Audit committee has the highest mean (28.4) with the SD=3.37, while transparency and access to information indicate the lowest mean (14.7) with SD=2.62.

Table 1. Corporate governance practices

	N	Minimum	Maximum	Mean	Std. Deviation
Board	34	11.00	25.00	19.0294	3.20497
External director	34	10.00	20.00	16.6176	2.41228
Transparency	34	9.00	20.00	14.7353	2.62053
Audit	34	23.00	35.00	28.4706	3.37760
Valid N (listwise)	34				

Table 2 outline the descriptive analysis conducted for HRM practices. Apparently, Work Flexibility exhibits the highest mean (19.17) with SD= 2.66, while performance appraisal indicate the lowest mean (8.14), with SD=1.37.

Table 2. HRM practices

	N	Minimum	Maximum	Mean	Std. Deviation
Teambased work	34	9.00	15.00	11.7059	1.56727
Work flexibility	34	9.00	25.00	19.1765	2.66823
Internal career	34	11.00	20.00	14.4118	2.31094
Employment security	34	11.00	20.00	15.5294	2.54933
Employee Participation	34	11.00	19.00	15.7353	2.03468
Training & Development	34	15.00	25.00	20.5000	2.45258
Performance	34	9.00	20.00	14.5000	2.52563
Employment security	34	11.00	20.00	15.3235	2.12803
Appraisal	34	5.00	10.00	8.1471	1.37361
Employee relation	34	4.00	20.00	13.9118	3.69576
Profit sharing	34	14.00	25.00	19.0588	2.05885
Valid N (listwise)	34				

Regression properties of SPSS were used to test the hypothesis. The result in table 3, indicates that there is a marginally significant relationship between corporate governance practices and HRM practices, as shown by the Sig= 0.056. This value shows a strong tendency towards significance. Thus, hypothesis 1 is accepted indicating corporate governance practices have an impact on the implementation of HRM practices.

Table 3. Corporate governance practices and HRM practices

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	105.690	23.975		4.408	0.000
Governance	0.600	0.303	0.331	1.982	0.056

Based on the result exhibited in table 4, Hypothesis 2 is rejected as the Sig= 0.984, indicate that the relationship between corporate governance practices and organizational performance is not significant.

Table 4. Corporate governance and organizational performance

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	19.138	4.021		4.759	0.000
Governance	-0.001	0.051	-0.004	-0.020	0.984

The result in table 5 indicates that HRM practices are significantly related to organizational performance. This can be seen from the level of sig= 0.026 in the above table. Thus, Hypothesis 3 is accepted.

Table 5. HRM and organizational performance

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	9.796	3.970		2.467	0.019
HRM	0.061	0.026	0.382	2.341	0.026

However, the mediation test involving HRM practices as the mediator between corporate governance practices and organizational performance was not analysed as the earlier results in H2 were not significant. This does not meet the criteria set by Baron and Kenny (1986) which requires the relationship in the two hypotheses to be significant, only then a mediation test can be conducted. From the above analyses conducted, H1 and H3 are accepted, while H3 and H4 are rejected.

5. Discussion and conclusion

The significance of H1 is meaningful, even though, the significance is only marginal but the result implies that there is a link between corporate governance practices implemented in companies and the types of HRM practices implemented. This provides evidence that it is possible to conceptualize HRM practices from a corporate governance perspective, meaning, corporate governance of a company will determine the HR policies and practise implemented. The outcome of this study parallels with the argument made by Konzelmann et al. (2006) that HRM practices are affected by the corporate governance practices.

The insignificant result for H2 between corporate governance practices and organizational performance is however consistent by one of the stream in corporate governance study that states there is no relationship between these variables. This can be referred to Park, and Shin (2003), Prevost, Rao and Hossain (2002), Singh and Davidson (2003) and Young (2003).

The significance of H3 between the relationship of HRM and organizational performance provides the evidence that HRM plays an important role for companies and this parallels previous studies. This implies a direct relationship between HRM and organizational performance and corresponding with the outcome of Al-Kaha, Al-Zubi,Al-Dmour, Al-Shurideh and Masa'adeh (2011) that human resource policies are positively related to organizational performance.

Most importantly, the findings of the study reveal that the stakeholder approach is a viable approach to be taken in studying corporate governance. Despite the difficulties in gaining co-operation and responses from the companies involved, it proves that the stakeholders specifically the employees are aware of the issue of corporate governance and the companies are required to raise and maintain their standards.

This study is conducted based on only 34 listed companies in the consumer product of bursa Malaysia. Therefore, a small sample size is identified as the main limitation for making a generalization about the selected sector in this study. The low response may be attributable to the policy of the companies not to disclose their corporate information. It is recommended that further study on the relationship between corporate governance and HRM practices to be conducted by integrating various sector of the economy to capture a higher number of observations. By having a larger sample, it is possible to get a significant result for the relationship between corporate governance and organizational performance which allow for a mediation test involving HRM practices. It is also interesting to identify the mediating effect of employee satisfaction resulted from HRM practices in specifying the relationship between corporate governance and organizational performance.

Appendix A. Supplementary material

Supplementary data associated with this article can be found, in the online version, at http://dx.doi.org/10.14254/2223-3822.2016.14-1.4

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