

# Directors' Tenure and Earnings Response Coefficients of FTSE KLCI Top 30

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## Abstract

The independence of non-executive directors has long been a concern. The independent directors are not only required to be independent from management but also free from any other relationships which can interfere with their objectivity. Recently, the concern has been focused on long tenure. Regulators seem to believe that long tenure may impair independence, hence attempts to limit the tenure have been recommended, even though it has not been made mandatory. However, theories concerning long tenure are contradictory and empirical evidences are weak. Earlier studies are based on theory-driven approach, which only examines the association between directors' tenure and proxies of financial reporting quality. This study on the other hand, proposes a different approach based on earnings response coefficient model which not only examines investors' perceptions but also their reactions. This is based on the widely accepted independence model where independence should not only be in the form of fact but also appearance. Using the sample of top 30 FTSE KLCI companies in 2016, OLS regression show higher ERC for companies with higher average tenure which implies that investors' perceived higher reliability of earnings produced by those companies. The result is consistent with the resource dependence theory which looks at the role of directors beyond the common monitoring roles but by focusing on more broader aspects of directors' responsibility.

**Keywords:** Capital market, director, independence, tenure.

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## 1. INTRODUCTION

The latest introduction of the new Malaysian Code on Corporate Governance (MCCG) 2017, which was effective beginning 26 April 2017 as replacement for the 2012 Code, has the objective of introducing a few substantial changes and recommendations in line with raising the standards of corporate governance of companies in Malaysia. The 2012 code required that in cases where the chairman of the company is not an independent director, the board must comprise a majority of independent directors. In all other cases, there was no requirement that independent directors should constitute a majority. The Code now provides that at least half of the board must comprise independent directors and, for large companies, there must be a majority of independent directors (MCCG, 2017).

Consistent with the approach under the 2012 code, the MCCG 2017 discourages an independent director from serving for more than nine years. Retention of an independent director above nine years will require the shareholders' approval, whereas retention of an independent director above 12 years will require the shareholders' approval through the two-tier voting process: (a) Tier 1: Voting by large shareholder(s) and (b) Tier 2: Voting by other shareholders. The rationale in the limitation of tenure is that long tenure can impair the directors' independence. As argued by Vafeas (2003), long tenure creates close relationships between the

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independent directors with the management and therefore, is more likely to befriend the managers. The attempt to limit the tenure can also be observed in other jurisdictions and similar to Malaysia, the “comply or explain” model is also applied in many other jurisdictions. For example, the European Commission recommends for three terms or twelve years while, in the United Kingdom, the U.K. Corporate Governance Code sets a maximum tenure of nine years, which is also similar to Hong Kong and Singapore, but in French, twelve years is the recommended maximum tenure. Meanwhile, in India, the Companies Act, 2013 sets a maximum of two tenures of five consecutive years, with a cooling-off period of three years. However, in the U.S, public companies do not have specific tenure limits for their independent directors.

As the recommendations set out in MCGC are not made mandatory, hence long tenure can still be considered a common practice in Malaysian public listed companies. This can be observed from a few reports conducted earlier, for example in a study by KPMG Malaysia (2013) of the top 300 companies ranked by market capitalisation in 2013, it had found that 33% of independent directors have served for more than 9 years. It is also reported that the average tenure of independent non-executive directors is 7.6 years, while on the other hand, only 6.6 years by non-executive non-independent directors. In another study, the Bursa Malaysia’s Analysis of Corporate Governance Disclosures in Annual Reports of 2012-2013 (2014) of 300 listed companies had found that 55% (165 companies) retains at least one independent non-executive director beyond the 9 years tenure. Based on top 100 Malaysian companies, the Minority Shareholder Watchdog Group (MSWG)’s 2015 survey had found increasing percentage of companies that have directors over 9 years from 34% in 2012 and 38% in 2013 to 46% in 2014. In 2015 about 44% of those companies have directors retained over 9 years. However, average tenure of 6 years for 2013 to 2015 is lower from 7 years recorded in 2012. Meanwhile, based on all listed companies, more than 50% of companies have an independent director with the tenure of more than 9 years, except for 2013 of only 47%. In an earlier report by Hay Group (2012) of 50 largest companies in 2010 by ASEAN countries showed that the median tenure of independent directors of 6 years in Malaysia is longer than 4.5 years in Indonesia and 3 years in Thailand, but shorter than 7 years in Singapore.

The debate on directors’ independence or broader aspects; board of directors independence, is not new as can be observed from the literature. This issue can be traced back from the argument regarding the need for the inclusion of non-executive directors as board members (Fama, 1983; Fama & Jensen, 1983) to the recent issue; which is the independence of independent directors. As the highest authority in a company, the board is mandated by the shareholders to protect their interests by ensuring all the activities of the company are for the benefits of the company. The popular belief is that directors who are truly independent are effective monitors. Currently, Chapter 15 of the Bursa Malaysia Listing Requirements requires at least two or one third of the board of directors to consist of independent directors and for audit committee, the minimum composition is three, consisting all non-executive directors and a majority of independent directors. Consistent with other countries, the Bursa Malaysia has defined the independent director as a director who is independent of management and free from any business or other relationships which could interfere with the exercise of independent judgement or the ability to act in the best interests of the company. More specifically, as in Chapter 1.01 Bursa Malaysia Listing Requirements, an independent director should not be an executive director, an officer within the last two years, a major shareholder, family member of any executive directors, officer or major shareholder, acting as a nominee or representative of any executive director or major shareholder, engage as adviser or is partner, director (except for independent director) or major shareholder of corporation which provides professional advisory services and engaged in any transaction individually or as partner, director or major shareholder of a corporation (other than subsidiaries of the company). However, the Listing Requirements is silent on directors’ tenure.

This study examines the effect of independent directors’ tenure on the financial reporting quality based on the investors’ perspective. By using the earnings response coefficient model proposed by Houlthausen and Verrochia (1988), this study intends to not only examine investors’ view but also their reactions. This study is important considering long tenure of directors is a common practice, not only in Malaysia but also elsewhere. It is also relevant for the regulators in reviewing the current policy which then may enhance investors’ confidence towards the capital market and provides empirical evidence on the currently debated issue on limiting independent directors’ tenure.

## **2. LITERATURE REVIEW**

### **2.1 Board of directors**

Managers are appointed as agents to act on behalf of shareholders in managing a corporation. This separation between owners and management causes conflicts of interest between the two parties, where the managers’

preferences are not aligned with the shareholders (Jensen & Meckling, 1976; Fama & Jensen, 1983). Board of directors is a market solution to ameliorate this agency problem (Hermalin & Weisbach, 2003), whereby as the highest authority in the corporate structure, the board is discharged with the responsibility of monitoring and controlling the management. Besides that, the board is also responsible to make decisions relating to policy of the corporation, strategic planning and the appointment, dismissal and compensation of management (Fama & Jensen, 1983). They receive those powers from shareholders with the purpose to protect their interests. Limbasiya (2013) points out the role of board as to maximize the total value for investors, customers, employees, government, society and other stakeholders. It is common nowadays to observe that board of directors consists of a mixture of top management, largest shareholders or its representative and a few individuals unrelated to the company of shareholders. Appropriate composition of members in terms of demographic, skills, expertise, experience, value system enhances the effectiveness of the board and this diversity safeguards them against single minded group thinking (Limbasiya, 2013). As not involved in the management, the inclusion of the outside directors is believed to enhance the monitoring and controlling. The non-executive directors have the incentive to build reputations as expert monitors (Fama, 1980; Fama & Jensen, 1983).

## **2.2 Directors Independence**

Hermalin and Weisbach (2003) argued that the major conflict within the boardroom is between the CEO and the other directors. The CEO is argued to have the incentive to capture the attention of the board of directors, so as to secure his position and remuneration, the non-executive directors on the other hand, is expected to provide the relevant “check and balance” to the executives. However, with the growing number of corporate scandals involving the management, the effectiveness of non-executive directors in monitoring these management has become an issue. One main centre of discussion is the independence of these directors. This is because in discharging their responsibility will require them to have a different perspective from management and sometimes even have the capacity to challenge the management. The traditional two-way classification scheme of insider (management) and outsider (non-management) directors have failed to consider the potential conflicts of interest when directors are not employees but have other affiliations with the firm (Byrd & Hickman, 1992). Although non-executive directors are not involved in the management or the company, they may not be independent due to their indirect relations to management which can later interfere with their objectivity. Therefore, it is believed that the non-executive directors are only able to perform more objectively if they are free from any personal bias resulting from financial or personal relationships with the management (Beasley, 1996; Carcello & Neal, 2000, 2003). It can be observed that current requirements in many jurisdictions have differentiated the non-executive directors into non-independent non-executive directors and independent non-executive directors. The widely practiced classification of non-executive directors who are representative of the substantial shareholders or are related to the founder, controlling shareholders or managing directors are classified as non-independent directors.

Independence is widely recognized as one of the main criteria for quality monitoring and control. Being responsible for oversight, board of directors need to adopt a probing attitude, questioning management’s judgments and to take positions that variance with the management (McMullen & Raghunandan, 1996). Independence allows the committee to deliver its responsibilities objectively (Mohamad & Sori, 2001) and independent directors are expected to play a two-fold roles; as a strategic advisor and the protector of the minority shareholders and other stakeholders’ rights (Limbasiya, 2013). However, Mirvis & Savitt (2016) recognized the fact that the independent directors lack detailed operational knowledge and firm specific commitment, thus the composition of the committee is one important determinant of its ability to act independently (Scarborough, Rama & Raghunandan, 1998). The inclusion of more independent directors on the board is believed to be able to enhance board independence.

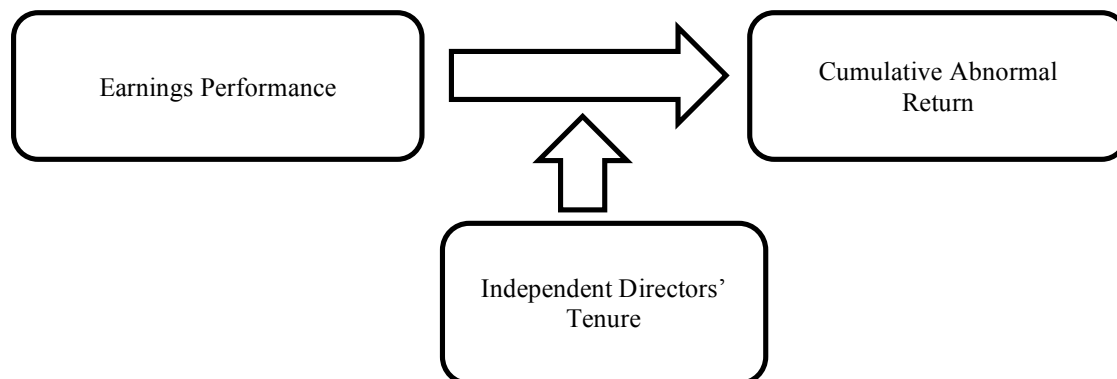
The typical independent director definition ignores the possibility that independence is based on a director’s personal profile and the relationships created in the boardroom over time (Byrd & Cooperman, 2010). Therefore, the current concern on directors’ independence is long tenure of independent directors which have been debated to impair their independence. Regulators’ action worldwide is to relegate the status of independent directors to non-independent after a period of time. Their action is being related to the belief that long tenure may impair directors’ independence. As noted by Romanchek and Keckley (2014) long tenure directors can become too close to long services CEO (and with other managers), become stagnate in the role or become too comfortable and not ask the difficult questions. The friendliness hypothesis proposed by Vafeas (2003) views long tenure directors as more likely to befriend managers which then can impair their independence and thus, objectivity. Long tenure can also be considered an obstacle in achieving board diversity.

### 3. THEORETICAL FRAMEWORK

It is widely recognized that the independence of monitoring is not only important in terms of fact, but also in appearance. The fact that stakeholders cannot directly observe the work of independent directors, it is important for the directors at least to be seen as independent. It can be observed that predictions regarding the effects of independent director's tenure on their effectiveness as monitors seem to contradict. Based on the theory of organizational behaviour, longer tenure increases an individual's commitment (Buchanan, 1974). At the same time, the expertise hypothesis views that longer tenure increases directors' experience and specific knowledge about the corporation (Vafeas, 2003). Sharma & Iselin (2012) argued that in an efficient market for directors, long tenure directors have higher incentives to protect shareholders' interest in order to maintain their seats. Long service directors have high reputation developed over time and therefore, are less likely to be associated to anything that will dramatically impair their reputation (Liu & Sun, 2010). At the same time, Persons (2015) argued that lack of seniority has an adverse effect on directors' ability to scrutinize top management. Other versions view that the effectiveness of independent directors deteriorates with the tenure. The friendliness hypothesis proposed by Vafeas (2003) views long tenure directors are more likely to befriend managers which then can impair their independence and thus, objectivity. As noted by Romanchek & Keckley (2014) long tenure directors can become too close to long service CEOs (and with other managers), become stagnate in the role or become too comfortable and not ask the difficult questions. Newly appointed directors have also been argued to have incentives to signal their expertise as monitors to the market (Sharma & Iselin, 2012). At the same time, Liu & Sun (2010) postulated that by having new directors can bring fresh ideas and critical thinking to the board. In other words, by having a new director may safeguard against single minded group thinking.

Mixed findings can also be observed on the effect of tenure on directors' effectiveness as monitors. A study by Sharma & Iselin (2012) had found that the average tenure of audit committees is positively related to misstatements. It is also found that short tenure (less than four years) and long tenure (more than eight years) are positively related to misstatements and the study concluded that the optimum director tenure is between 4 to 8 years. Vafeas (2003) found that increase in mean tenure is associated with greater incidence of negative earnings avoidance. Meanwhile, Rickling (2014) found that long tenure is positively associated with the likelihood of a firm repeatedly meeting or just beating analysts forecast. On the other hand, Liu & Sun (2010) and He & Yang (2014) both had found that long tenure is negatively associated with earnings management which the studies relate to the increase in directors' expertise.

One main responsibility of independent directors is to monitor the financial reporting process. Even though, financial accounts are prepared by the management, the independent directors are responsible in ensuring the quality of these accounts. Quality financial reporting is the key success of a capital market, whereby it relieves the fundamental asymmetry of information used in investment decisions. While many have shown that earnings performance is positively related to abnormal return of shares (Mahmoudi, Shirkavand & Salari, 2011; Ismail & Rahman, 2012), Houlthausen & Verrochia (1988) models investors' view on the quality of earnings reported in financial accounts as the strength of coefficients between the earnings and abnormal return. Therefore, it is hypothesized that independent directors' tenure is significant and negatively related to earnings response coefficients, whereby independent directors' tenure acts as a moderating variable to the relationship between earnings performance and cumulative abnormal return, as visualized below.



#### 4. RESEARCH METHODOLOGY

Sample is based on FTSE Bursa Malaysia KLCI companies for the year 2016. It comprises of the largest 30 companies by market capitalisation. The information of directors' profile is collected from the annual reports and the share prices is obtained from the Bursa Station. As presented in Table 1, the sample consists of 14 trading and services companies, 7 finance companies, 2 industrial products, 2 consumer products, 2 plantations and 1 each from construction, infrastructure project companies and REITS.

Table 1. Distribution of sample based on sectoral classification

Sector	No. of companies	Percentage of sample
Trading/ Services	14	46.7
Finance	7	23.3
Consumer products	2	6.7
Industrial products	2	6.7
Plantation	2	6.7
REITS	1	3.3
Construction	1	3.3
Infrastructure Project Corporation	1	3.3

Previous studies are based on theory driven approach, which examines association between independent directors' tenure and proxies of financial reporting quality (Sharma & Iselin, 2012; Rickling, 2014). This study will use the market approach, whereby both investors' perceptions and actions are examined together. Event study methodology will be applied where the effect of independent directors' tenure on the quality of financial reporting is examined based on investors' reactions. This approach is adopted from Holthausen & Verrechia (1988)'s model of earnings response coefficient, where it examines investors' reactions on the earnings reported in financial accounts at the time of release (announce). Low reliability of earnings perceived by investors is postulated to result in lower earnings response coefficients. The model is based on semi-strong efficient market model by Fama (1970) which posits that investors will instantaneously adjust their expectations on assets' value upon receiving new information which in turn is reflected instantaneously in asset prices. While many have shown that earnings performance is positively related to abnormal return of shares (Mahmoudi, Shirkavand & Salari, 2011; Ismail & Rahman, 2012), Holthausen & Verrechia (1988) hypothesized that the earnings response coefficient will increase with the perceived quality of the earnings by investors. Therefore, the effect of independent directors' tenure on earnings response coefficient will be examined using the Ordinary Least Square regression and will take the following form:

$$CAR = EP + EP * TENURE + ASSET \quad (1)$$

Where;

CAR = Cumulative abnormal return

EP = Earnings performance

TENURE = Independent directors' tenure

ASSET = Asset size

Significant and negative coefficient of EP \* TENURE will provide support for the hypothesis that investors place low reliability on earnings reported by companies with long tenure of independent directors.

The Sharpe (1964)'s market model is used in measuring the abnormal returns. The abnormal return of stock *i* on date *t* will be calculated as the difference between the actual return and the expected return for this date and will take the following form:

$$AR_{it} = R_{it} - E(R_{it}) \quad (2)$$

where;

AR<sub>it</sub> = Actual return of stock *i* on date *t*

R<sub>it</sub> = Return of stock *i* on date *t*

E(R<sub>it</sub>) = Expected return of stock *i* on date *t*

The R<sub>it</sub> is calculated as the difference between the closing price on date *t* and date *t-1* divided by closing price on the date *t-1*. The E(R<sub>it</sub>) is derived from the following equation.

$$E(R_{it}) = \alpha_i + \beta_i R_{mt} \quad (3)$$

where;

E(R<sub>it</sub>) = expected return of company *i* on day *t*

R<sub>mt</sub> = market index return on day *t*,

α<sub>i</sub> = unsystematic returns for company *i*,

β<sub>i</sub> = systematic risk for company *i*.

The model assumes a stable linear relation between the market return and the share return. The estimated coefficients,  $\alpha$  and  $\beta$  are calculated by regressing the stock returns with market returns using daily closing prices and daily Bursa Malaysia Composite Index over the 200 trading days (-230; -31) using the ordinary least square regression. The FTSE Bursa Malaysia Composite Index is used as a proxy for the market return. It will be calculated as the difference between the market index on date  $t$  and date  $t-1$  divided by the market index on the date  $t-1$ . Meanwhile, the cumulative abnormal returns (CAR) is measured using the following equation:

$$CAR_i(t_0:t_2) = \sum_{t=t_0}^{t_2} AR_{it} \quad (4)$$

where;

CAR<sub>i</sub>(t<sub>0</sub>t<sub>2</sub>) = cumulative abnormal returns of company i from t<sub>0</sub> to t<sub>2</sub> day

AR<sub>it</sub> = abnormal return of company i on day t,

t<sub>0</sub> = announcement date of quarterly earnings

t<sub>2</sub> = day 2 after the announcement date

The widely used measurement of earnings performance is by dividing the difference between the actual earnings per share and expected earnings per share with the market value of share prior to the earnings' announcement date (Balsam, Krishnan & Yang, 2003; Krishnan, Sami & Zhang, 2005). However, whilst earnings forecast (the measurement usually used for expected earnings) is not publicly available in Malaysia, consistent with prior Malaysian studies, the naive expectation model is used (Fah & Nasir, 2010; Hussin, Ahmed & Ying, 2010). The model assumes that the next period's expected earnings is the current period's earnings. Therefore, the following measurement is used in measuring earnings performance:

$$EP_{it} = [EPS_{it} - EPS_{it}(t-1)] / [P_{i-2}] \quad (5)$$

where;

EP<sub>it</sub> = earnings performance of companies i for year t,

EP<sub>St</sub> = earnings per share of companies i for year t,

EP<sub>Si</sub>(t-1) = earnings per share of companies i for year t-1,

P<sub>i-2</sub> = share prices of companies i, on 2 day prior to the earnings announcement.

Tenure is measured by the average number of years of independent directors' tenure while, ASSET<sub>i</sub> is measured by the natural logarithm of total assets.

## 5. RESULTS

### 5.1 Descriptive Analysis

The total assets of the 30 companies is RM3.1 trillion with the average of RM105 billion. However, the assets range from RM1.2 billion to RM736 billion which implies a dispersion of assets among the sample. As presented in Table 2, five companies with less than RM10 billion of assets recorded and eight companies with assets of more than RM100 billion. The large amount of assets is consistent with the fact that all of the companies selected as sample are among the largest companies listed on Bursa Malaysia (based on market capitalization).

Table 2. Distribution of sample based on assets

No. of independent directors	No. of companies	Percentage of sample
Less than RM10 billion	5	16.7
RM10 billion to RM20 billion	7	23.3
RM20 billion to RM30 billion	3	10.0
RM30 billion to RM40 billion	2	6.7
RM40 billion to RM50 billion	0	0
RM50 billion to RM60 billion	1	3.3
RM60 billion to RM70 billion	2	6.7
RM70 billion to RM80 billion	1	3.3
RM90 billion to RM100 billion	1	3.3
RM100 billion and more	8	26.7

Meanwhile, all the sample have recorded profits and ranges from RM339 million to RM7.368 billion with the average of RM1.904 billion which also represent a dispersion of profit among sample. As in Table 3, ten companies with profits of between RM500 million to RM1 billion, nine companies with profits between RM1 billion to RM2 billion and six companies are with profit of between RM2 billion to RM3 billion.

Table 3. Distribution of sample based on profit

Amount	No. of companies	Percentage of sample
Less than RM500 million	1	3.3
RM500 million to RM1 billion	10	33.3
RM1 billion to RM2 billion	9	30.0
RM2 billion to RM3 billion	6	20.0
RM3 billion to RM4 billion	1	3.3
RM4 billion to RM5 billion	0	0
RM5 billion to RM6 billion	1	3.3
RM6 billion to RM7 billion	1	3.3
RM7 billion to RM8 billion	1	3.3

Meanwhile, as presented in Table 4, 14 companies have lower EPS than the previous year and 16 companies have higher EPS. It ranges from -66.1 cents to 67.8 cents with an average of 3.70 cents.

Table 4. Distribution of sample based on EPS performance

Amount	No. of companies	Percentage of sample
More than -60 cents	1	3.3
-60 to -40 cents	0	0
-40 to -20 cents	4	13.3
-20 to 0 cents	9	30.0
0 to 20 cents	12	40.0
20 to 40 cents	3	10.0
40 to 60 cents	0	0
More than 60 cents	1	3.3

As shown in Table 5, out of 30 companies, a total of 136 independent directors are observed with an average of 4.5 per board. The minimum number of independent directors on the board is three and a maximum of eight. A majority (57 percent) of the sample have three or four independent directors on the board. The number is consistent with the Bursa Malaysia Main Market Listing Requirements which sets that companies must have at least 2 independent directors or  $\frac{1}{3}$  of the board (Chapter 15.02).

Table 5. Distribution of independent directors based on companies

No. of independent directors	No. of companies	Percentage of sample
3	9	30
4	8	26.7
5	6	20
6	4	13.3
7	1	3.3
8	2	6.7

Meanwhile, as in Table 6, out of 136 directors observed, two directors have been appointed after financial year end and another 20 are appointed during the financial year. This indicates that 16 percent of independent directors is newly appointed, with a total of 14 companies have these directors. On the other hand, 21 directors have served the board for more than 9 years, which represents 15 percent of independent directors in the sample and two directors are found to have served on the board for more than 20 years. Overall, the average director's tenure is 5.8 years, which is slightly lower than 7.6 years reported by KPMG Malaysia (2013) of the top 300 companies.

Table 6. Distribution of independent directors based on tenure

Tenure	No. of directors	Percentage of directors
0-1 year	22	16.2
1-9 years	93	68.4
9 and more years	21	15.4

Meanwhile, as shown in Table 7, only three companies (10 percent) have average director's' tenure of more than 9 years. Most board (70 percent) have average tenure of between 3 to 7 years.

Table 7. Average independent directors' tenure by companies.

Average tenure	No. of sample	Percentage of sample
0-3	1	3.3
3-5	13	43.3
5-7	8	26.7
7-9	5	16.7
More than 9 years	3	10.0

## 5.2 OLS Regression Analysis

Table 8 presents the correlation results between the variables used in this study. As can be observed, the correlation between EP and EP\*TENURE is 0.8755 and significant at 1 percent level. Thus, to address this matter, two separate OLS regression analyses are conducted and the results as presented in Table 9 for the variables EP and ASSET, while in Table 10, for EP\*TENURE and ASSET.

Table 8. Correlation results

Variables	EP	EP*TENURE	ASSET
CAR	0.3932 (0.0316)	0.3964 (0.0301)	0.2269 (0.2279)
EP	1.0000	0.8755 (0.0000)	0.1538 (0.4171)
EP*TENURE		1.000	(0.0933) (0.6237)

(p-value)

As shown in Table 9, the adjusted R-squared is 0.1225 and is significant at a 10 percent level. The variable EP is positive and significant at 5 percent level (2-tailed) which represents that the earnings performance has a significant and positive effect on the cumulative abnormal return. The adjusted R-squared of 0.1225 and significant at 10 percent level, implies that the variables used can only explain 12.25 percent of the model.

Table 9. OLS Regression Analysis

Variables	Coefficients	p-value
EP	0.0033	0.047
ASSET	0.0046	0.342
Constant	-0.0507	0.320
Adjusted R-squared	0.1225	0.0653

Table 10 presents the OLS regression results, where in this regression, variable EP is replaced with EP\*TENURE since the correlation between both variables is 0.8755, which signals multicollinearity. The coefficient of EP\*TENURE is found to be positive and significant at 5 percent level (2-tailed test). The result implies that investors place higher reliability towards the earnings of companies with higher independent directors' tenure. This result however, contradicts the presumption made earlier in the hypothesis, which mainly can be explained by the fact that the sample chosen for this study represents the 30 largest companies in Bursa Malaysia by market capitalization and the independent directors of these companies are usually very influenced persons from various backgrounds. Hence, by having longer tenure for these independent directors on the board may signal to investors a better and more stable image of the company. This is consistent with the resource dependence theory which views directors as resource providers that supplies legitimacy, advice and counsel to the firms (Hillman et al., 2000; Hilman & Dalziel, 2003; Pfeffer & Salancik, 1978). The theory looks beyond the monitoring roles of the directors by focusing on broader aspects of directors' responsibility and the board is viewed as a mechanism for managing external dependencies, reducing environmental uncertainty and reducing the transaction costs associated with environmental interdependency (Pfeffer & Salancik, 1978). Meanwhile, the adjusted R-squared of 0.1338, indicates that 13.38 percent of the dependent variable can be explained by the independent variables. In summary, the use of EP\*TENURE in replace of EP has increased the explanatory strength by more than 1 percent.

Table 10. OLS Regression Analysis

Variables	Coefficients	p-value
EP*TENURE	0.0004	0.038
ASSET	0.0051	0.280
Constant	-0.0553	0.273

## 6. CONCLUSIONS

Long tenure of independent directors has been a concern in many countries. Regulators view long tenure as impairing directors' independence and has led to tenure limitation in many jurisdictions. However, the "comply or explain" model is favoured in many countries. Theories concerning long tenure among independent directors are mixed. On one side, longer tenure is theorized as increasing an individual's commitment towards an entity. Longer tenure has also been hypothesized to enhance directors' experience and specific knowledge about the corporation. On the other side, the friendliness hypothesis views long tenure as impairing directors' independence through their close relationship with the management throughout the tenure. At the same time, by



having a new director has also been postulated to bring in fresh ideas and thus, safeguard the company against single minded group thinking. This is added with the widely accepted independence model which highlights that independence should not only be in the form of fact, but also in appearance. This study proposes that long tenure of independent directors shall result in lower reliability of earnings reported in financial accounts by the investors due to their concern on directors' independence. Based on the earnings response coefficient model, it is argued that the interaction between long tenure and earnings performance have a significant negative relationship with cumulative abnormal return. However, the result seems to contradict from earlier prediction, whereby the coefficient of EP\*TENURE is found to be positive and significant, thus implies that investors place higher reliability towards the earnings of companies with higher independent directors' tenure. This result is consistent with the resource dependence theory which looks at the role of directors beyond the common monitoring roles but by focusing on broader aspects of directors' responsibility. For independent directors of large companies especially in Malaysia, their roles may be broader and their reputations as influenced personnel are put to good use to build up the reputation of the company. Hence, there is no reason to doubt that their tenure may be viewed more positively by investors as compared to those of smaller companies. However, due to the limitation in the sample of this study, the findings may not represent the wider population of companies listed in Bursa Malaysia. The results may only imply to large companies as in our sample. Thus, it would be interesting to perform similar analyses on a whole population of listed companies.

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