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An Empirical Analysis on the Association between Corporate Governance Rating and Firms' Characteristics: Evidence from MAI Thailand

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Abstract
The primary purpose of this paper was to investigate the association between good corporate governance and firm-related characteristics of listed firms in the Market for Alternative Investment (MAI), Thailand. The degree of good corporate governance was measured by the corporate governance rating publicly reported on the 2012 corporate governance report of Thai listed companies (CGR) by Thai Institute of Directors (IOD). Using the logistic regression analysis, results from this study revealed that the return on assets and free cash flow are significantly related to good corporate governance. Since these two variables measure the profitability of firms, it can be concluded the good governed firms have a higher profitability than the weaker ones. However, the debt-to-equity ratio, current ratio, assets turnover, firm's growth, earnings per share, dividend yield, age of firms, and size of firms are not statistically related to good corporate governance.
Keywords: Corporate Governance, Corporate Governance Rating, Market for Alternative Investment, Thailand, logistic regression
JEL Codes: G30

1. Introduction

Corporate governance is one of the control mechanisms that assist stakeholders, e.g. shareholders, creditors, investors, etc. to control and monitor the management's decision making. It can help reduce the agency problems, arising from the goal divergence of agents and principals (Shleifer & Vishny, 1997). Therefore, the implementation of effective corporate governance practices lead to transparency in administering the firms by the management, raise the stakeholders' confidence in firm's performance, and eventually increase the firm's value (National Corporate Governance Committee, 2013).

In Thailand, the Stock Exchange of Thailand (SET) and National Corporate Government Committee (NCGC) have published corporate governance guidelines, called as "the 15 Principles of Good Corporate Governance" for Thai listed firms. These corporate governance

best practices are not compulsory, but are encouraged (Securities and Exchange Commission, 2013). Furthermore, in order to observe and evaluate whether all listed firms in Thai stock market have complied these best practices, Thai Institute of Directors (IOD) has surveyed and issued the report, "Corporate Governance Report of Thai Listed Companies (CGR)", annually since 2001. The report discloses how well the listed firms act in accordance with the corporate governance best practices, based on five categories of principles; (i) rights of shareholders, (ii) equitable treatment of shareholders, (iii) roles of stakeholders, (iv) disclosure and transparency, and (v) board responsibilities. The listed firms are evaluated and are classified into categories. Only listed firms receiving governance rating as "excellent", "very good" and "good" are reported to the public as they earned the corporate governance scores relatively high between 90-100 scores, 80-89 scores, and 70-79 scores, respectively. These firms are presumed to be well- governed firms. However, listed firms that earned scores less than 70 scores will not be publicly announced and they are presumed to be weak governed firms. (Thai Institute of Directors, 2013).

Recently, many Thai listed firms have realized the benefits of corporate governance as an important tool used to improve their operations. More firms have attempted to comply with the corporate governance best practices as it was revealed that on the 2012 corporate governance report of Thai listed companies (CGR) that a number of firms receiving "excellent" score rating increased from 9% in 2011 to 13% in 2012 and a number of firms receiving "very good" and "good" score rating increased from 62% in 2011 to 64% in 2012.

As the corporate governance rating is a one mechanism to encourage firms to comply with the corporate governance best practices, and to distinguish good governed firms from weak one, this study then examined whether there are any firm characteristics related to good corporate governance and if any of them can be used to discriminate well-governed firms from others.

Furthermore, there are two primary capital markets in Thailand. These are the Stock Exchange of Thailand (SET) and the Market for Alternative Investment (MAI). Firms listed on the Stock Exchange of Thailand (SET) are large firms, whereas firms listed on the Market for Alternative Investment (MAI) are small and medium-sized firms. This study emphasized on the characteristics of firms listed on later capital market due to two reasons. First, the empirical evidence, particularly on the corporate governance of small and medium-sized firms listed on Thai stock market, is limited. Second, although firms listed on the Market for Alternative Investment (MAI) are high potential firms, investors may be less confident about the performance of these firms. Hence, the primary objective of this paper was to examine the association between corporate governance rating and firm-related characteristics of the firms listing on the Market for Alternative Investment (MAI), Thailand. Recently, there are 85 firms listed on the Market for Alternative Investment (MAI), accounting for 14 percent of firms listed on the stock markets in Thailand.

The paper is organized as follows. The next section presents prior empirical evidence relating to the study. The third section explains the data collection and research methodology. The fourth section describes the empirical results and discussion on the results. The last section is for the conclusion.

2. Prior Studies

Agency cost of any firms arises because of the conflict of interest between the agents, e.g. management and the principals, e.g. shareholders. Such agency cost diminishes the value

of the firms (Jensen & Meckling, 1976). Nonetheless, the agency cost can be reduced if firms are in compliance with good corporate governance practices, leading an increase in firms' performance. Gompers, Ishii, and Metrick (2003) revealed that during 1990-1999, good governed firms in the U.S. tend to have more profits, higher sales growth, greater stock returns, and lower capital expenditure. Also, these governed firms were less likely to be acquired by others. In addition, Jinarat and Quang (2003) pointed out that in the case of Thailand, the implementation of effective corporate governance can increase the firm's performance. Moreover, Bauer, Guenster, and Otten (2004) stated that investors would have more confidence to invest in well-governed firms as they believed these firms are less risky. Furthermore, Berthelot, Morris, and Morrill (2010) evidenced that for Canadian firms, effective corporate governance is a type of information investors consider when making a decision because it directly impacts the market value of firms. Furthermore, Reddy, Locke, and Scrimgeour (2010) confirmed that the corporate governance practices can impact the performance of listed firms in New Zealand Stock Exchange positively. Finally, Ergin (2012) reported that corporate governance rating affects positively net income and equity of firms. Therefore, investors would consider corporate governance rating when valuing stock prices of Turkish firms. Consequently, corporate governance is beneficial to the firms and their stakeholders.

Many firm-related characteristics contribute to good corporate governance. They can be used to discriminate well-governed firms from the weaker ones. Ragothaman and Gollakota (2009) investigated the impact of accounting and financial characteristics of 85 U.S. firms on corporate governance. Using logistic regression, they found out that the return on assets is positively related to good corporate governance. They then concluded that the return on assets is an important variable used to distinguish "best" governed firms from the others. This finding is consistent with the study of Renders, Gaeremynck and Sercu (2010) in the analysis of 14 European countries. Renders et al. (2010) suggested that firms having good corporate governance index are more likely to have higher returns on assets than other firms.

Besides, Jensen and Meckling (1976) asserted that firms tend to have more efficient operations as they practice good corporate governance, leading to an increase in expected future cash flow. Ergin (2012) indicated that with efficient operating performance, well-governed firms are more likely to have greater positive cash flow. This excess amount of cash flow would be distributed to shareholders in form of dividends, rather than be assumed by managers for their self-maximizing interest (Jensen, 1986). Indeed, the returns to shareholders will attract more investors to invest in the firms, resulting in an increase in share price and firm's market value. As a result, the free cash flow and firm's market value are significant variables related to good corporate governance. As shareholders expected that well-governed firms should pay dividend (Jensen, 1986), Ragothaman and Gollakota (2009) attempted to investigate the relationship between the dividend payout and corporate governance. However, they asserted that dividend payout is not statistically related to good corporate governance.

In addition, Gruszczynski (2006) reported that operating profit margin and debt leverage ratio of firms listed on Warsaw Stock Exchange (WSE) are significantly related to corporate governance rating, whereas asset turnover ratio and liquidity ratio are insignificant. He found out that firms having better corporate governance rating possess higher profits and lower debt leverage ratio. In terms of leverage, consistent with Gruszczynski (2006), Ragothaman and Gollakota (2009) showed that well-governed firms have lower debts than

the weak ones. It is because these good governed firms are monitored and controlled by the market. Hence, the leverage of firm is important to improve corporate governance.

In terms of firm's size, it is expected to have an influence on corporate governance. Large firms are more diversified, receive more benefits from economics of scales, and have better access to lower costs of source of funds (Leng, 2004). Therefore, large firms have greater ability to comply with corporate governance best practices, leading to an increase in firm performance. Ragothaman and Gollakota (2009) provided the empirical evidence that well-governed firms are those large firms. This result is in accordance with the study of Black, Jang, Kim (2006) in the case of Korean listed firms. However, Sun, Tong, and Tong (2002) asserted that large firms might have more agency problems and turn out to be less efficient than smaller ones. Hence, the evidence about the effect of firm's size on corporate governance is still contradicted. Lastly, Klapper and Love (2004) suggested that firms having more growth are more likely to have better corporate governance. Hence, firm's growth is one of the variables that can be used to discriminate well-governed firms from others.

3. Methodology

3.1 Data Collection

The sample in this paper is composed of firms having securities listing on the Market for Alternative Investment (MAI) during 2011-2012. The data of these firms were retrieved from the BLOOMBERG and SETSMART databases. After excluding the firms with unavailable data, a total of 67 observations were employed in this study.

3.2 Variables

The dependent variable is corporate governance rating. It is a binary variable where 1 equals to firms awarded "excellent", "very good", and "good" corporate governance rating and 0 is otherwise. The firms coded with 1 were those with better corporate governance than firms coded with 0. The information regarding corporate governance rating was from "Corporate Governance Report of Thai Listed Companies (CGR) in 2012", issued by Thai Institute of Directors Association.

In addition, there are ten independent variables in this study. First is the return on assets, measuring the profitability of firm. Second is the debt-to-equity ratio, indicating firm's leverage. Third is the current ratio, a proxy of liquidity. Fourth is the asset turnover, measuring firm's effectiveness in asset management. Fifth is firm's growth. Sixth is free cash flow, pointing out the amount of available cash provide to securities holders of firms. Next variable is the earnings per share, used to measure the effective of management to use capital to generate profits. Later is the dividend yield, a variable reflecting market's favorable perception of firms. The last two variables are age and size of firms. Table 1 below presents the independent variables and their measurements. Nonetheless, all data relating to independent variables corresponds to year 2011 since the corporate governance reported was published in year 2012.

Table 1: Independent Variables and their measurements

Independent variables	Measurements
Return on assets	Net income divided by average total assets

Debt-to-equity ratio	Total debts divided by total equity
Current ratio	Current assets divided by current liabilities
Asset turnover	Net sales divided by average total assets
Firm's growth	The 1-year average growth of firms' sales
Free cash flow	Operating cash flow minus capital expenditures
Earnings per share	Earnings available to common shareholders divided by common shares outstanding
Dividend yield	Dividend per share divided by stock price per share
Age of firm	The number of years since established
Size of firm	The natural logarithm of total assets

3.3 Logistic Regression Model

To examine whether the corporate governance rating is associated with firm-related characteristics, the logistic regression analysis is employed. The following model is proposed:

$$CG_{it} = \alpha_0 + \beta_1 ROA_{it-1} + \beta_2 DTE_{it-1} + \beta_3 CUR_{it-1} + \beta_4 ATURN_{it-1} + \beta_5 SGROW_{it-1} + \beta_6 FCF_{it-1} + \beta_7 EPS_{it-1} + \beta_8 DIVY_{it-1} + \beta_9 AGE_{it-1} + \beta_{10} SIZE_{it-1} + e_{it-1} \quad (1)$$

Where, *CG* = Binary variable where 1 equals to firms awarded firms awarded "excellent", "very good", and "good" corporate governance rating and 0 is otherwise

ROA = Return on assets
DTE = Debt-to-equity ratio
CUR = Current ratio
ATURN = Asset turnover
SGROW = Firm's growth
FCF = Free cash flow
EPS = Earnings per share
DIVY = Dividend yield
AGE = Age of firm
SIZE = Size of firm
β_0 = Constant term
β_k = A vector of parameters to be estimated, where k = 1,2,…..,10
e_{it-1} = Error term

4. Empirical Results & Discussion

4.1 Descriptive Statistics

Table 2 provides a summary of descriptive statistics. For the book value-based financial ratios, the mean of return on assets (*ROA*) was 5.87 percent, the mean of debt-to-

equity *(DTE)* was 120.81, the mean of current ratio *(CUR)* was 2.86, the mean of assets turnover *(ATURN)* was 1.17, the mean of firm's growth *(SGROW)* was 23.76 percent, and the mean of free cash flow was 17.02 million baht. In terms of market-based ratios, the mean of earnings per share (*EPS*) was 0.43 baht and the mean of dividend yield was 4.01 percent. In addition, the age of firms (*AGE*) in sample was from 7 years to 51 years, and the average firm's age was 20 years. Lastly, the size of the firms (*SIZE*), measured by total assets, on average was 7.57 million baht.

Table 2: Descriptive Statistics (n = 67)

Variables	Minimum	Maximum	Mean	Std. Deviation
ROA	-50.88	30.58	5.87	13.40
DTE	0.00	4,673.05	120.81	568.67
CUR	0.40	23.60	2.86	3.96
ATURN	0.06	3.54	1.17	0.56
SGROW	-84.27	276.89	23.76	53.17
FCF	-996.66	1,412.98	17.02	256.89
EPS	-0.96	6.64	0.43	0.95
DIVY	0.00	50.00	4.01	6.59
AGE	7.00	51.00	20.61	8.91
SIZE	5.08	8.32	6.63	0.73

4.2 Normality Test

To test whether a set of data in this study is normally distributed, the Shapiro-Wilk test was used. Table 3 below shows the results of the normality test. Evidence shows that the *p*-value of each variable, except firm's size (*SIZE*), is statistically significant at 0.05 level. All variables, except firm's size (*SIZE*), are not normally distributed. However, the result was not surprising for firm's size (*SIZE*), which is only one variable that is normally distributed, since the natural logarithm of total assets is used to measure the size of the firm.

Table 3: Results on the Shapiro-Wilk Normality Test

Variables	Shapiro-Wilk Statistic (*df = 67*)	P-Value
ROA	0.816*	0.000
DTE	0.170*	0.000
CUR	0.516*	0.000
ATURN	0.939*	0.003
SGROW	0.783*	0.000
FCF	0.677*	0.000
EPS	0.551*	0.000
DIVY	0.512*	0.000
AGE	0.926*	0.001
SIZE	0.985	0.593

*significant at the 0.05 level.

4.3 Univariate Test of Difference

Since all variables, except firm's size, are not normally distributed, to investigate whether two separate groups of corporate governance rating in this study are significantly different from each other in terms of firm-related characteristics, the Mann–Whitney *U* test (nonparametric test) was employed. With this test, it is assumed that the response variable, corporate governance rating is influenced only by one predictor variable.

Table 4 represents the results of the univariate test. It was reported that the mean rank of return on assets (*ROA*) of two groups are statistically different at 0.05 level, in which the mean rank of returns on assets of the firms awarded "excellent", "very good", and "good" corporate governance rating are greater than that of the other group. This implies that on average firms with better corporate governance have higher profitability than the other group.

Table 4: Results on the Mann–Whitney *U* test

Firm's characteristic Variables	Group 1[a] (n=48)		Group 0[a] (n=19)		Wilcoxon Z-score	
	Mean Rank	Sum of Ranks	Mean Rank	Sum of Ranks	Score	P-Value
ROA	37.94	1821.00	24.05	457.00	-2.629*	0.009
DTE	33.44	1605.00	35.42	673.00	-0.376	0.707
CUR	35.23	1691.00	30.89	587.00	-0.821	0.412
ATURN	36.15	1735.00	28.58	543.00	-1.433	0.152
SGROW	34.19	1641.00	33.53	637.00	-0.125	0.900
FCF	38.04	1826.00	23.79	452.00	-2.699*	0.007
EPS	37.79	1814.00	24.42	464.00	-2.532*	0.011
DIVY	38.19	1833.00	23.42	445.00	-2.854*	0.004
AGE	33.60	1613.00	35.00	665.00	-0.265	0.791
SIZE	36.21	1738.00	28.42	540.00	-1.474	0.140

[a] Group coding where 1 = Firms awarded 5-star, 4-star, and 3-star corporate governance rating and 0 = otherwise.

*significant at the 0.05 level.

Moreover, evidence shows that the mean rank of free cash flow (*FCF*) of two groups is statistically different at 0.05 level. Firms awarded "excellent", "very good", and "good" corporate governance rating have higher free cash flow available to equities' holders than the other group. Furthermore, the mean rank of earnings per share (*EPS*) is significantly higher in firms awarded "excellent", "very good", and "good" corporate governance rating than those

of the other group at the 0.05 level. Since the earnings per share measure firms' profitability, firms having better corporate governance are more efficient in generating more profits by using their capitals. Indeed, the dividend yield (*DIVY*) of two groups has a difference in mean rank, which is statistically significant at 0.05 level. It was found out that the firms awarded "excellent", "very good", and "good" corporate governance rating have higher dividend yield greater than the other group. Nonetheless, the debt-to-equity *(DTE)*, current ratio *(CUR)*, assets turnover *(ATURN),* firm's growth *(SGROW*) age of firms (*AGE*), and size of firms (*SIZE*) are not statistically different in means between two groups at 0.05 level.

4.4 Logistic Regression Results

Even though the Mann–Whitney *U* test revealed that return on assets (*ROA*), free cash flow (*FCF*), earnings per share (*EPS*), and dividend yield (*DIVY*) are significantly different between two groups at 0.05 level, it does not mean that only these four variables can be used to discriminate one group from the other group and have statistically significant association with corporate governance rating. Therefore, all proposed predictor variables were examined through the logistic regression analysis to determine whether a response variable, corporate governance rating, is influenced by multiple predictor variables. Table 5 presents the results from the logistic regression analysis.

Table 5: Logistic Regression Results

Independent Variables	**Coefficients (*β*)**	**Wald Chi-square (*P-Value*)**
ROA	0.087*	3.002 *(0.083)*
DTE	0.001	0.571 *(0.450)*
CUR	0.009	0.005 *(0.941)*
ATURN	1.020	1.432 *(0.231)*
SGROW	-0.007	0.979 (*0.323*)
FCF	0.003*	3.291 *(0.070)*
EPS	-0.426	1.039 *(0.308)*
DIVY	0.136	1.236 *(0.266)*
AGE	-0.023	0.345 *(0.557)*
SIZE	0.898	2.613 *(0.106)*
Constant (α)	-6.072	2.253 *(0.133)*
Model Statistics:		

Model Chi-Square (*df, sig.*)	25.118* (*10, 0.005*)
-2 log likelihood	54.787
Cox & Snell R Square	0.313
Nagelkerke R Square	0.449
Hosmer & Lemeshow Chi –Square (*df, sig.*)	7.473 (*8,0.487*)
Percent correctly classified (cutoff value =0.5)	82.10%

*significant at 0.10 level

Evidence from Table 5 shows that return on assets (*ROA*) is statistically significant at 0.10 level. The positive coefficient of this variable indicates the positive relationship between the corporate governance rating and return in assets (*ROA*). This means that an increase in return in assets (*ROA*) increases the chance of being a well-governed firm. Firms with good corporate governance are more effective to use assets in generating profits than the other group. As a result, they have greater returns on assets than the other group. This finding is consistent with Ragothaman and Gollakota (2009) and Renders et al. (2010).

Moreover, it was found out that free cash flow (*FCF*) is statistically significant at 0.10 level, with positive coefficient. This implies that an increase in free cash flow (*FCF*) increases the chance of being a well-governed firm. Firms with good corporate governance are likely to have more cash available to equities' holders than others. These well-governed firms are more attractive to investors as an increase in free cash flow often are the results of an increase in revenues, a reduction in costs or a decrease in debts, further signaling an increase in future earnings of firms. This can finally increase the value of shareholders. The finding from this study then supports the assertion of Ergin (2012).

However, table 5 shows that the debt-to-equity ratio (*DTE*) is not statistically significant at 0.10 level. This insignificant relationship points out that the leverage of firms are not related to the chance of being a well-governed firms. Hence, the degree of debts, as a proportion of firm's equity cannot be used to discriminate good governed firms from others. Moreover, the current ratio (*CUR*), assets turnover (*ATURN*) and firm's growth (*SGROW*) are not statistically significant at 0.10 level. These insignificant findings admit that firm's liquidity, asset management effectiveness, and growth of firm are not significantly related to corporate governance rating. The ability of firm to settle the short-term debts by current assets, ability of managing assets effectively and growth of firms, cannot be used to discriminate well-governed firms from the other groups

Though earnings per share (*EPS*) and dividend yield (*DIVY*) were found to be significantly different between two groups, they are not statistically related to the corporate governance rating, when considering other predictors simultaneously. Hence, Firms having high (low) earnings per share and/or high (low) dividend yield will not influence the corporate governance rating to be higher or lower. The finding regarding dividend yield is in accordance with the study of Ragothaman and Gollakota (2009).

Furthermore, firm's age (*AGE*) and firm's size (*SIZE*) are not statistically significant at 0.10 level. The number of years in operation does not influence the corporate governance rating. Both young and old firms have a chance to be well-governed or poorly-governed firms. Also, the size of firm does not impact the corporate governance rating. Although larger firms are able to assess resources easier, have more resources, have better reputation, and are more attractive to the investors than smaller ones, the regression result reported that both large and small firms are able to be well-governed or poorly-governed firms.

5. Conclusion

A set of corporate governance practices is an important control mechanism that can help increase confidence of stakeholders regarding firm's performance. In case of Thailand, all listed firms are evaluated whether they are in accordance with the corporate governance best practices. These firms will be given corporate governance rating. Only firms earning "excellent", "very good", and "good" scores will be reported to the public, while others will be not. This corporate governance rating is beneficial to stakeholders when considering firm's performance. Hence, this study seeked to address the relationship between good corporate governance and the characteristics of small and medium-sized firms listed on the Market for Alternative Investment (MAI), Thailand.

Empirical evidence from this study indicates that return on assets (*ROA*) and free cash flow (*FCF*) are positively related to corporate governance rating. Since these two variables are the measurement of firm's profitability, it can be concluded that firms earning more profits are more attractive to investors and have more incentive to carry good corporate governance practices, leading to a high degree of corporate governance rating. In addition, it was found out that these two variables can be used to discriminate well-governed firms from the weaker ones.

Results from this study may provide important information regarding the significant characteristics of listed small and medium-sized firms that can be employed to distinguish well-governed firms from the weaker ones. Such information can assist investors in making a proper decision when investing in this alternative market. Moreover, evidence from this study adds to the understanding of the characteristics of small and medium-sized firms that contribute to better corporate governance in the international context.

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