

Corporate Governance Development in Malaysia

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Abstract

This literary study examines the development of corporate governance practice in Malaysia as per the Malaysian Code on Corporate Governance 2012 (MCCG). Its origin and historical development are reviewed to understand the core purpose of corporate governance that is currently practiced in Malaysia. Analysis on previous studies on corporate governance practice in Malaysia is also done to highlight the impacts of and loopholes in the practice. Then, summary of these analyses is done to observe the level of conformity and deviance to the practice so that suggestions can be made to improve corporate governance practice in the future. This paper is part of the literature review of a doctoral study and its significance shall serve as a reference to the policy makers, higher academic institutions and corporate key-players in Malaysia towards building an effective corporate governance practice.

Keywords: Corporate governance, Malaysia

1. INTRODUCTION

‘Corporate governance’ first came into limelight in the 1990s following the prominent United Kingdom’s corporate scandals of Maxwell and Polly Peck. During the period, the available standard test of ‘honest and reasonable man’ to demonstrate accountability was questioned. Regardless of the judgments, the available tests at that period were held to be insufficient to cater for corporate governance problem i.e. mismanagement, conflict of interest, overlap of powers, misappropriation of company’s fund, lack of accountability and transparency.

2. CORPORATE GOVERNANCE: ORIGIN AND DEVELOPMENT

As grave as the outcome of the Polly Peck case was, loopholes in the previous United Kingdom (UK) Companies Act 1985 (CA 1985) were successfully exposed. The CA 1985 was insufficient to cover the issues of power abuse by major directors and weak roles of the non-executive directors (NED) and auditors (Belcher, 2014; J. Solomon, 2007). The term ‘corporate governance’ was introduced by Sir Adrian Cadbury (1992) in the Cadbury Report as “a system by which companies are directed and controlled”. The pillars to the system – ethics, fairness and transparency were deemed appealing to the shareholders who were mostly traumatized by the Polly Peck case (Steinthorsdottir, 2004). The development of corporate governance in the UK can be further observed in Table 1 below.

Table 1: Development of Corporate Governance in the UK.

Year	Title	Development
1992	Cadbury Report	'Corporate governance' was introduced and defined (Cadbury, 1992)
1994	Rutteman Report	'Internal control' was extended to include financial reporting to keep track of money flow (Steinhorsdottir, 2004)
1995	Greenbury Committee – Code of Best Practice	'Directors' remuneration' and 'individual performance' were directly linked to control unjustified, excessive remuneration among BOD (Hughes, 1996; Smerdon, 2004)
1996	Hampel Report	More power allocated to NED to encourage self-scrutiny on companies' performance and to promote check and balance of power (Beaver, Davies, & Joyce, 2007)
1998	Combined Code of Corporate Governance	'Compliance requirement' was upgraded from 'comply or justify non-compliance' to also include 'steps of compliance'
1999	Turnbull Guidance	Full disclosure of 'material information' was highlighted (Carey, 2001; Zaman Mahbub, 2001) due to faint impact of corporate governance save for an increase in boards restructuring which was done only to fulfill the basic requirement of the code. 'Box-ticking mentality' (Hamill, McGregor, & Rasaratnam, 2006; Writer, 2001)
2001	Myners Review	'Shareholders activism movement' encouraged institutional shareholders to actively participate in the voting of NED (Slattery & Nellis, 2005; Smerdon, 2004; J. F. Solomon & Solomon, 2006). Resulted in greater emphasis on 'trustees' professionalism', added test of 'prudent investor rule' for trustees, and the revision of a number of existing UK company laws (Kakabadse & Kakabadse, 2005)
2002	White Paper Operational and Financial Review	UK government initiated Company Law Review in 1998 resulting in corporate governance and public disclosure to be made mandatory from 2005 onwards (Parkinson, 2002)

The change from deregulation was caused and in fact amplified by another series of fresh high profile corporate scandals emerging from the neighbouring country, the United States (US) – Enron, Worldcom, Adelphia and Tyco, among the prominent many (Jones & Pollitt, 2004). The US initiated swift control measure through the enactment of the infamous Sarbanes-Oxley Act 2002 (SOA 2002).

The SOA 2002 quickly gained public attention as the Act was gazetted only six months after the findings of Enron case. The initiator, Commissioner Paul Sarbanes Atkins (2007) commented that the Act was desperately needed to curb the rapid corporate catastrophe experienced in the US although admitting that it was such a sudden action and was highly risky as well.

Academics were no less receptive either. Romano (2004) called the Act as a 'quack governance'; while Nordberg (2008) forecasted that the Act would cause more harm than good as foreign companies would soon delist themselves in the US simply for the reason of escaping its radical effect.

However, it is recognized that the Act did cast a worldwide impact. 'Governance revolution' emerged in that period as various countries responded to the Act by carefully analysing its contents to understand the principles and functions proposed by the Act so that they can strengthened their own corporate governance practice (Green & Gregory, 2005; Herz & McGurr, 2006). Even the UK itself, being the founding country, also responded to the Act by initiating Higgs Review in 2002 before proceeding with the aforementioned White Paper and the Operating and Financial Review.

3. CORPORATE GOVERNANCE DEVELOPMENT IN MALAYSIA

The framework of Malaysia's company law was originally adopted from the UK CA 1948 before it was switched to Australia's Companies Act 1961 and ended there to allow its own reform, resulting in the currently applied Companies Act 1965 (CA 1965). Similar to the US, corporate governance practice was almost non-existent, save during the Asian Financial Crisis during the period of 1997 – 2001. It resulted in the introduction of corporate

governance through the Malaysian Code of Corporate Governance (MCCG) in 2000 and the Bursa Malaysia Revamped Listing Requirement in 2001 (Abdul Rahman & Haneem Mohamed Ali, 2006; Tie Fatt Hee, 2003).

The MCCG defines corporate governance as “the process and structure used to direct and manage the business and affairs of the company towards enhancing business, prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value, whilst taking into account the interest of other stakeholders” (Securities Commission Malaysia, 2012). It embodies the spirit of corporate governance prescribed by Sir Adrian Cadbury in 1992, only more detailed. The elaboration on the current MCCG’s principles (2012) can be observed in Table 2.

Table 2: MCCG 2012 Principles and elaboration.

Principle	Keyword	Elaboration
1	Clear roles and responsibilities	<ul style="list-style-type: none"> i. BOD and CEO to have separate functions ii. BOD to monitor over management body to discharge fiduciary duty iii. Formalize corporate code of conduct iv. Sustainability – environment, social and governance v. Sufficient disclosure of information i.e. the board charter vi. Qualified and competent company secretary who reports directly to BOD
2	Transparency	<ul style="list-style-type: none"> i. Nominating Committee with majority independent NED as members. Tasked to oversee the selection and assessment of directors. ii. Establish criteria for directors’ recruitment and annual assessment process. iii. Establish and disclose gender diversity policy iv. Formalized remuneration policies and procedures v. Remuneration Committee with majority of NED as members
3	Independence	<ul style="list-style-type: none"> i. Disclose annual assessment for independent directors ii. Mitigate risks of conflict of interest or undue influence iii. Nominating Committee to develop criteria to assess independence iv. Independent director’s tenure to not exceed nine years v. Strong justification and shareholders’ approval for independent director exceeding nine years tenure vi. Chairman and CEO to hold different responsibilities to promote accountability vii. Chairman to be independent director, if not BOD must be a majority of independent directors to ensure balance of power
4	Foster	<ul style="list-style-type: none"> i. Set target time to fulfill responsibilities ii. Continuous education and training programs to update knowledge and skill
5	Integrity	<ul style="list-style-type: none"> i. Audit Committee to ensure financial statement to comply with applicable financial reporting standards ii. Policies and procedures to assess independence of external auditors
6	Risk management	<ul style="list-style-type: none"> i. Disclose risk management framework and internal controls system ii. Internal audit function to report directly to Audit Committee iii. Regular reviews and appraisals of the effectiveness of governance, risk management and internal controls processes
7	Disclosure	<ul style="list-style-type: none"> i. Practical internal corporate disclosure policies and procedures which comply with the disclosure requirements of BMLR ii. Use of technology to effectively disseminate information
8	Relationship	<ul style="list-style-type: none"> i. Encourage shareholders to participate at general meetings ii. Sufficient notice serve for meetings to ensure participation iii. Disclose all relevant information to the shareholders iv. Encourage poll voting v. Effective communication and stakeholder engagements

Prior to the earlier MCCG 2000, companies registered under the CA 1965 relied heavily on the statutory provisions for protection against abuse of powers by the directors. It became an issue when the general rule of a director to exercise powers for proper purpose’ and in good faith in the best interest of the company as per s 132 (1) was left for the court to interpret and determine based on circumstances of the cases at hand.

For example, in *Co-operative Central Bank Ltd (In receivership) v Feyen Development Sdn Bhd [1995] 3 MLJ 313*, the court, by referring to the Australian Companies Act 1981 and comparing its s 234 with s 132 stated that the requirement of good faith in the provision was too broad when there were scattered measures on aspects of such duty. It then cited *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd (1978) 139 CLR 410*, stating that “general rule is subject to exceptions and, at the end of the day, it is a question of construction of the particular statute”. The introduction of MCCG in 2000 simplifies the matter as director’s duties are listed down accordingly for the companies to refer to.

For example, in *Tenaga Nasional Berhad v Manfield Development Sdn Bhd and Anor [2010] MLJU 909*, the Appellant appealed against the specific performance action claimed by the Respondent to complete the sale and purchase of its shares. The Respondent Company claimed that as the Appellant was ‘directed’ by the Government of Malaysia to purchase its shares (despite at exaggerated price), the Appellant then should have not breach the contract by refusing to proceed with the sale and purchase agreement.

The Appellant, in its defence, explained its position in corporate governance by referring to the MCCG, stating that despite the demand by the Government to purchase the shares, the company still has to act its own best interest as it has fiduciary duty to all its shareholders. As such, the Appellant were duty-bound to scrutinize the ‘proposal’ for sale and purchase and any decision must be justified by ‘sound commercial principles’ and the creation of ‘shareholder value’. It was held that as the Government has no legal authority to override the Appellant’s decision as it is ‘legally wrong’ and ‘contrary to the spirit of good governance’, the Appellant then was freed from the specific performance order.

From the comparison of these two cases (pre and post-MCCG), it can be assumed that somehow MCCG does improve the position of companies in Malaysia.

3.1 Impacts and loopholes of corporate governance practice in Malaysia

As corporate governance practice is still relatively new in Malaysia and only a few cases have been decided in the courts based on MCCG, studies done by academic researchers are analysed and reviewed next to further discover the impacts and loopholes (if any) of the practice in Malaysia. This can be seen in Table 3.

Table 3: Impacts and loopholes of corporate governance practice in Malaysia

Author	Study	Elaboration	Issue
Haniffa & Cooke (2002)	Relationship between culture (race) of BOD and voluntary disclosure level in the annual report.	Malays BOD have higher uncertainty avoidance and lower individualism compared to Chinese BOD who have higher secrecy and lower disclosure level.	Limited race analysis may result in biasness. Faint attribution to major aspects such as religion, education and type of industry run by the company.
Hassan & Christopher (2005)	Relationship between religion and corporate governance disclosure in annual report of banks in Malaysia published in 2003.	The result contradict that of Haniffa and Cooke. Since the MCGG was newly introduced at that period (2000), the implementation may have yet to be fully utilized.	Religion give no impact at all to corporate governance disclosure.
Abdul Rahman & Haneem Mohamed Ali (2006)	Relationship between the composition of BOD and audit committee.	Analyses done on annual reports published in the period of 2002 – 2003 (MCGG was still fresh).	Compliance on corporate governance was only on the surface.
Nahar Abdullah (2006)	Relationship between the roles of BOD (duality and pattern of ownership) and directors' remuneration.	Highlights on directors' remuneration after the Asian Crisis (1999 – 2001) and how it affect companies' performance.	Companies' performance is not a major factor that determine directors' remuneration (which was in contrast with the principle of MCGG back in 2000).
Simon Shim (2006)	Analysis on the 'box-ticking mentality' among Malaysian companies.	Highlights the function of Kuala Lumpur Stock Exchange (now Bursa Malaysia Berhad) as enforcement officers.	Training and the need to develop a regulatory framework which promotes market self-discipline. Awareness.
Yatim, Kent, & Clarkson (2006)	Relationship between external audit fees and internal corporate governance structure.	Bumiputras' owned companies have better internal corporate governance practice compared to the non-Bumiputra based on annual reports published in 2003.	Support Haniffa and Cooke but no elaboration on the cause of different quality.
Alam Choudhury & Ziaul Hoque (2006)	Analysis on organizational theory in corporate governance.	Conventional corporate governance is based on rationalism which is problematic because of complex relations among human beings.	Proposed Islamic perspective to corporate governance which was against MCGG 2000 which had no preference in religion and was more universal in nature. Should have localized corporate governance practice to local context instead.

Author	Study	Elaboration	Issue
Hassan Che Haat et al. (2008)	Relationship between good corporate governance practice and companies' performance.	Analyses done on annual reports published in 2002. Hypotheses to higher companies' performance were related to: <ul style="list-style-type: none"> i. Stronger internal governance mechanism ii. Higher foreign ownership and debt financing iii. Higher audit quality 	The companies chosen for the study showed insufficient material disclosure practice.
Aswadi Abdul Wahab, Mat Zain, James, & Haron (2009)	Relationship between institutional ownership and political-connected firms with audit quality.	Institutional investors and political-connected firms pay higher audit fees.	Transition period of Malaysia leadership may cause changes in favor of political-connected firms.
Rachagan & Satkunasingam (2009)	Analysis on the practice of corporate governance by the SMEs.	Concentrated shareholding is a hinder to successful corporate governance practice.	Cultural values do give an impact on corporate governance.
Reddy (2009)	Analysis on cultural influences to the overall approach to stakeholders in Asian region.	State-ownership and concentrated shareholding are disadvantages.	Support the need to localized corporate governance practice.
Ahmad - Zaluki & Nordin Wan - Hussin (2010)	Analysis on financial disclosure quality through management earnings forecasts disclosed in prospectuses.	Annual reports published during 1999 – 2006. Higher number of independent NED resulted in greater forecast accuracy and corporate governance effectiveness.	Focus on the Initial Public Offering only.
Anum Mohd Ghazali (2010)	Relationship between ownership structure and MCGG 2000 application.	Annual reports published in 2001 showed faint impact of corporate governance.	Corporate governance practice is still insignificant in Malaysia.
Aswadi Abdul Wahab, Mat Zain, & James (2011)	Relationship between political connection, corporate governance and audit fees.	Annual reports published during the period of 2001 – 2003.	Box-ticking mentality still occurred. No improvement to corporate governance practice since Simon Shim.
Alnasser (2012)	Analysis on the history of corporate governance in Malaysia.	MCCG is improved to be more stringent and standardized.	No analysis on the actual impact of corporate governance to companies' performance.
Sulaiman Abdullah Saif Alnasser & Jorah Muhammed (2012)	Analysis on corporate governance from Islamic perspective.	<i>Shariah</i> board monitoring is the highlighted difference.	No analysis on the impact of <i>Shariah</i> board monitoring when applied to the banks' governance framework.
Ho & Taylor (2013)	Analysis on corporate governance impact on annual reports.	Strong corporate governance structure produced more transparent report.	No elaboration on the features of strong corporate governance structure.

3.2 Results

Previous studies on local context highlights the fact that companies in Malaysia practice a unique type of shareholding compared to companies in other countries. ‘Concentrated shareholding’ whereby the shareholders consist mostly of family members or blood-related shareholders causes certain difficulties when it comes to practicing the existing corporate governance. The negative impacts caused by majoring members in a company such as conflict of interest, lack of transparency and accountability are amplified in the case of companies with concentrated shareholding as they rely mostly on mutual trust and underlying confidence rather than logic and reasons as in *Tien Ik Enterprises Sdn Bhd & Ors v Woodsville Sdn Bhd [1995] 1 MLJ 769*. This issue is countlessly cited in the studies by Haniffa & Cooke (2002), Aswadi Abdul Wahab, Mat Zain, James & Haron (2009), Rachagan & Satkunasingam (2009) and Reddy (2009).

As the companies in Malaysia experience difficulties in adapting to the principles set in corporate governance, it is to be expected that ‘box-ticking mentality’ to occur as the companies simply adopt corporate governance practice without understanding the basis of such principles as set out in the studies done by Abdul Rahman & Haneem Mohamed Ali (2006), Nahar Abdullah (2006), Simon Shim (2006), Hassan Che Haat (2008), Anum Mohd Ghazali (2010) and Aswadi Abdul Wahab, Mat Zain & James (2011). This explained the conflict experienced in *Sime Darby Bhd & Ors v Dato’ Seri Ahmad Zubair @ Ahmad Zubir bin Hj Murshid & Ors (Tun Musa Hitam & Ors, third parties) [2012] 9 MLJ 464* whereby when the Plaintiff Company sued the Defendants for breach of fiduciary duties, negligence and unauthorised payments, the Defendants reacted by blaming the whole Board and Committee members of the Plaintiff Company for authorizing their actions in the first place, thus dragging the rest of them as parties to the civil suit for indemnity. Although the court held against the Defendants, it was disheartening that despite the Defendants’ breach of various fiduciary duties – gross negligence, incompetence, concealment, manipulation of information, dishonest representation, non-disclosure of material information, and several more – nothing was done by the members of both Board and Committee members of the Plaintiff Company who were mostly NED. Both of the Defendants held the highest position in the Plaintiff Company group.

Therefore, it is suggested that studies to be done in the future on the need to localize corporate governance to assist the companies in Malaysia of which majority of them practice concentrated shareholding. A study on corporate governance based on Islamic perspective is being done based on this paper and is hoped to be one, if not the best, solution when it comes to localizing corporate governance practice to assist the situation of companies in Malaysia. This proposal is based on the studies done by Hassan & Christopher (2005), Alam Choudhury & Ziaul Hque (2006), Rachagan & Satkunasingam (2009), Reddy (2009) and Sulaiman Abdullah Saif Alnasser & Jorih Muhammed (2012).

4. RESEARCH METHODOLOGY

The objective of the study is to understand the corporate governance practice of companies in Malaysia. The methodology used was qualitative in nature as it chose to discover patterns that help explain the lack of corporate governance practice by companies in Malaysia as suggested by Sukamolson (2007). It is a legal research as it involves a ‘systematic finding’ or ‘ascertaining law’ on corporate governance practice in Malaysia as well as an ‘inquiry’ into such law with a view to improve it (Vibhute & Aynalem, 2009).

Data were collected through primary sources in form of statutes, rules, regulations and case laws; as well as secondary sources which include books and journals. In addition, data were also collected from unpublished materials such as conference papers, thesis and other various related materials. Doctrinal analysis, also known as document or content analysis is done whereby the identified laws were critically evaluated in terms of their principles, doctrines and their relationship. It is one of the most crucial part in sociological research, in particular legal research as analyses done are mostly revolved around provisions of laws.

5. CONCLUSION

From the study, it can be concluded that:

- i. Race, religion and politics influence BOD in their approach to corporate governance practice
- ii. Companies in Malaysia practice a different pattern of ownership i.e. concentrated shareholding which affects the companies’ approach to corporate governance practice as well

- iii. Box-ticking mentality is still occurring in Malaysia as most companies lack the understanding of the core purpose of corporate governance i.e. lack of awareness and education
- iv. Islamic perspective on corporate governance is perhaps the best solution when it comes to localizing corporate governance practice to fit Malaysia's approach.

The current corporate governance practice in Malaysia lacks understanding from the companies themselves and proved to be, most of the time, insignificant. A study on developing corporate governance from Islamic perspective or from Malaysia's perspective is suggested to be done in the future to fill the found loophole in the governance corporate practice in Malaysia.

ACKNOWLEDGEMENTS

This paper is funded by the Malaysia Ministry of Higher Education (MOHE) under the *Halal* Supply Chain (HSC) Research Project Grant scheme [600-RMI/REG 5/3 (38/2015)] for Malaysia Institute of Transport (MITRANS), MARA University of Technology, Shah Alam, Malaysia.

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