Changing the Corporate Landscape: Enhancement of Corporate Governance in Malaysia

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Abstract

Questions about corporate governance emerged following the financial failures in Asia, Europe, and the United States. In Asia, the sharp depreciation of some of the countries' currencies and fall in the stock market during the 1997-98 period has been attributed to four reasons - failed corporate governance; inappropriate and weak economic policies; the International Monetary Fund's mistake in forcing an increase in interest rates resulting in the closure of some banks; and the "Pangloss equilibrium" that created a bubble in asset prices. Additionally, rampant cases of corporate greed and widespread abuse in the financial sectors further aggravated the crisis. Following the breakdown in the corporate governance regimes and market discipline, a number of countries embarked on reforming their corporate governance legislations. This article examines the three phases of corporate governance reforms in Malaysia which have significantly altered the corporate governance landscape.

I. INTRODUCTION

This article examines corporate governance reforms in Malaysia. First, it discusses corporate governance reforms in Asian countries and the first phase of the reforms in Malaysia vis-à-vis, the Code on Corporate Governance 2000. Secondly, it discusses the second phase of the corporate governance reforms that aimed to further strengthen the corporate governance regulatory framework through the Malaysian Code on Corporate Governance 2007 and the subsequent Malaysian Code on Corporate Governance 2012. Finally, it examines some of the challenges that regulators faced while implementing these reforms.

II. CORPORATE GOVERNANCE REFORMS IN ASIA

Most researchers attributed the Asian financial crisis to four reasons, namely: failed corporate governance[1]; inappropriate macroeconomic policy during the 1990s that was

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1 Haspeslagh P, "Corporate Governance and the Current Crisis", *Corporate Governance: The International Journal of Business in Society*, 2010, Vol. 10 Issue 4, pp. 375-380. Also available online at - http://www.emeraldinsight.com/doi/pdfplus/10.1108/14720701011069614. Site accessed on 5 January 2016.

further aggravated by inept management during the initial phase in 1997[2]; the International Monetary Fund's pressure on certain countries to increase interest rates that eventually led to the closure of a number of banks[3] and, the "Pangloss equilibrium" that led to a bubble in asset prices[4]. These four interconnected factors that contributed to the financial crisis also encompass elements of greed, wishful thinking and linear extrapolation, the persistent addiction to efficient capital markets and the principal-agent model thinking[5]. The crisis exposed the poor level of legal protection of minority shareholders, lack of transparency and financial disclosure, and various levels of cronyism embedded in a majority of corporations.

The outflow of foreign capital from Thailand set off a subsequent loss of confidence among local and foreign investors in other countries such as Malaysia, South Korea, and Indonesia. The collapse of the property and stock market, lack of prudential regulations, over exposure by banks, structural weaknesses in the domestic financial institutions and unsound macro-economic policies aggravated the crisis.[6] The crisis revealed a number of corporate scandals characterised by high levels of mismanagement, inadequate regulation and greed.

Generally, a weak corporate governance regulatory framework is the main reason that contributed to the financial meltdown. The existing legal mechanisms which minimises agency conflicts among managers, and the specific mechanisms that prevent the expropriation of minority shareholders appear to be weak. The corporate governance regulatory framework seems to be ineffective. Past research showed that when there is an increase in expropriation by managers as a result of a fall in the expected rate of return on investment, the subsequent loss of investors' confidence would eventually lead to an increase in expropriation, lower capital inflow and greater capital outflow[7]. These caused stock prices to fall and the exchange rate to depreciate. Under such circumstances, creditors and minority shareholders often received little legal protection. In situations where the prospect of economic growth is poor, a sound corporate governance regulatory framework is critical. Conversely, where shareholder protection is weak and ineffective, there is an increase in expropriation when an economic down turn occurs. Unfortunately, the expropriation of minority shareholders and creditors by the controlling shareholders is extensive in many countries. Investor protection is crucial to ensure that the returns on investments materialise without the threat of expropriation. To a certain extent, corporate governance provides investors some form of protection against expropriation by the insiders[8].

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2 Giancarlo Corsetti, et. al., "What Caused the Asian Currency and Financial Crisis?", NBER Working Paper Series, http://www.nber.org/papers/w6833.pdf . Site accessed on 22 April 2015.

3 Radelet S and Sachs J, "The Onset of the East Asian Financial Crisis", NBER Working Paper Series, http://www.nber.org/papers/w6680. Site accessed on 12 March.2015.

4 Krugman P, "What Happened to Asia?", http://web.mit.edu/krugman/www/DISINTER.html. Site accessed on 28 March 2015.

5 *Supra* n 1, at p. 375.

6 *Supra* n 4, at p. 3.

7 Johnson S, Boone P, Breach A, and Friedman E, "Corporate Governance in the Asian Financial Crisis", *Journal of Financial Economics*, 2000, Vol. 58, pp. 14-150.

8 La Porta R, Lopez-de-Silanes F, Shleifer A and Vishny R., "Investor Protection and Corporate Governance", *Journal of Financial Economics*, 2000, Vol. 58, pp. 3-20.

In Malaysia, the ineffective policies to address the devaluation of the ringgit resulted in a steep increase in the interest rate and consequent severe credit contraction. Consequently, corporate output and profits suffered severe contractions and the prices of equity fell significantly. The Kuala Lumpur Composite Index declined by 72% during the period from the end of June 1997 to the end of August 1998.

Subsequently, regulatory reforms were introduced to strengthen the corporate governance framework. Reforms in the corporate governance regulatory structure, among others, focused on improving financial disclosure, better monitoring via an improved board structure, and shareholder's empowerment. The reforms also addressed the following issues: - disclosure requirements; enhanced governance mechanisms with specific requirements on the role and composition of the board of directors and public enforcement[9]. Reforms to strengthen the corporate governance regulatory framework considered the existing weak market mechanisms, and specifically, the problems associated with asymmetric information, opaque corporations, and information overload.

Research showed that asymmetric information is one of the major causes of market failures and corporate scandals. According to Zalewska, asymmetric information is an issue in the business environment. This is due to three reasons, namely: (a) the increasing opaqueness of the corporations as a result of the rise of large scale businesses with complex organisational forms. This situation resulted in the emergence of greater informational asymmetry between investors and management; (b) rapid development in information technology which led to an increase in asymmetry. It has now become difficult to extract relevant and important information as more information that is made available creates the problem of information overload; and, (c) changes in ownership structure in line with the unprecedented growth of stock markets. Eventually, shareholders faced difficulty in monitoring the performance of the management.[10].

Consequently, a number of countries in Asia have introduced codes of corporate governance to address these problems. These regulatory reforms were successful in improving corporate governance in the respective countries. The establishment of the codes on corporate governance include the Malaysian Code of Corporate Governance in 2000 (the 'MCCG 2000'), South Korea's Code of Best Practices for Corporate Governance in 2003, the Singaporean Code of Corporate Governance in 2005, the Indonesian Good Corporate Governance Guideline in 2006, Thailand's Principles of Good Corporate Governance for Listed Companies in 2006, and the Philippines Code of Corporate Governance in 2009. These national codes on corporate governance had a common objective, that is, to improve the quality of the company's board of directors, increase corporate accountability to shareholders, and to further protect the interests of the investors.

In the context of Malaysia, corporate governance reforms were encapsulated in three main documents, namely: - the MCCG 2000 set out by the Finance Committee on

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9 Kim EH, Lu Y, "Corporate Governance Reforms Around the World and Cross-Border Acquisitions", *Journal of Corporate Finance*, 2013, Vol. 22, pp. 236-260.

10 Zalewska A, "Challenges of Corporate Governance: Twenty Years after Cadbury, Ten Years after Sarbanes-Oxley", *Journal of Empirical Finance*, 2014, Vol. 27, pp. 1-26.

Corporate Governance (the 'FCCC'); the Capital Market Master Plan by the Securities Commission ('the CMMP'); and, the Financial Sector Master Plan (the 'FSMP') by Bank Negara Malaysia.

In 2008, a second wave of financial crisis, commonly known as the global financial crisis 2008, afflicted the economies of many countries. The global financial meltdown in 2008 shows that despite the numerous measures and initiatives to reform and strengthen corporate governance globally, the reforms achieved limited success. Corporate scandals, such as Enron, WorldCom, Adelphia Communications, Maxwell Group, Polly Peck, Satyam, and Parmalat revealed persistent shortcomings in corporate governance that resulted in the loss of billions of dollars and jobs. These corporate scandals exposed a high level of mismanagement and insatiable greed. The lack of active disclosure and reporting along with a responsible and sound accounting and reporting system were some of the reasons that contributed to the economic disaster. Both the previous meltdown that occurred eight years ago and the consequent legislation, such as the Sarbanes-Oxley Act in the United States, and the waves of corporate governance rules and revised codes that were implemented across the globe does not seem to make any difference towards improving corporate governance. Despite considerable time and effort to reform the regulatory structure during the 1997-2008 period, corporate governance practices and control mechanisms appear to remain weak and ineffective. The lack of adequate regulation and prudential control, structural weaknesses of regulatory institutions and commitment continue to pose a challenge to good corporate governance.

III. CORPORATE GOVERNANCE REFORMS IN MALAYSIA – PHASE ONE: SETTING THE MILESTONE

The 1997 Asian financial crisis provided an impetus for the first phase of reforms in corporate governance in Malaysia. The crisis exposed a number of weaknesses among companies that were badly hit by the stock market collapse. In the late 1980s and the early 1990s, companies faced numerous problems that were related to abuse of corporate dealing, fraud, bribery, asset stripping, favouritism, and opaque corporate practices. There was a lack of an independent and accountable monitoring body to ensure transparency and proper implementation of policies.[11]

In March 1998, the Malaysian government established the Finance Committee on Corporate Governance (the 'FCCG'). The FCCG's main task was to identify and remedy weaknesses in the corporate governance framework. The FCCG recommended two major initiatives, namely: - (a) the implementation of the Malaysian Code on Corporate Governance 2000, and (b) the establishment of the Minority Shareholders Watchdog Group. The initial steps to strengthen the corporate governance regulatory framework addressed the following areas:- fair treatment for all shareholders and protection of shareholder rights, with specific focus on the rights of the minority shareholders; transparency through

[11] Vithiatharan V and Gomez ET, "Politics, Economic Crises and Corporate Governance Reforms: Regulatory Capture in Malaysia", *Journal of Contemporary Asia*, 2014, Vol. 44 No. 4, pp. 572-580. Also available online at - http://www.tandfonline.com/doi/pdf/10.1080/00472336.2014.933062. Site accessed on 10 May 2015.

the timely disclosure of adequate, clear and comparable information concerning corporate financial performance, corporate governance and corporate ownership; accountability and independence of the board of directors; strengthening regulatory enforcement and promoting training and education at all levels to ensure that the framework for corporate governance is supported by the necessary human resource capital.[12]

The MCCG 2000 represents a significant milestone in corporate governance reform. Based on the recommendations of the United Kingdom's Cadbury Report (1992) and the Hampel Report (1998), the MCCG 2000 attempted to codify principles and best practices of good governance as well as describe the optimal corporate governance structures and internal processes. It consists of four sections, namely: (a) Principles of corporate governance; (b) Best practices in corporate governance; (c) Exhortations to other participants; and (d) Explanatory notes and 'mere best practices'. The sections set out a broad and general guideline for the new corporate governance framework. Of more significance is the attempt to clearly define the role and functions of the board. Specifically, the MCCG 2000 focused on corporate reforms in four major areas, that is: - the board of directors; director's remuneration; shareholders and accountability and the audit. The MCCG 2000 strives to ensure that boards are able to function in a more transparent and responsible manner.

The recommendations for reform are almost similar to the provisions in the United Kingdom's Combined Code on Corporate Governance. The MCCG 2000 is prescriptive in nature even though it is regulatory driven. It sought to improve the quality of the company's board of directors, increase corporate accountability to shareholders, and improve the governance of companies to protect the various key stakeholders such as investors, directors, shareholders, political and social institutions.

The regulators decided to adopt a concerted and holistic approach towards the enhancement of corporate governance. The changes to the corporate governance system are significant as it has resulted in a stronger regulatory governance framework. Companies are accorded some degree of flexibility to apply the broad principles of good corporate governance set out in the MCCG 2000. The government, as in other ASEAN countries, has provided strong support to these reforms. In the latter, strong governmental support has resulted in the establishment of new institutions to monitor and enhance corporate governance, an increase in shareholder activism, and some positive changes among market participants' attitudes and behavior[13]. The regulators are aware that investors and shareholders recognise the positive benefits associated with high

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12 Securities Commission Malaysia, "Finance Committee Report on Corporate Governance", http://www.sc.com.my/finance-committee-report-on-corporate-governance/. Site accessed on 28 May2015.

13 The MCCG 2000 listed out six specific responsibilities of the board, that is - (a) to review and adopt a strategic plan for the company; (b) oversee the conduct of the company's business and assess whether the business is being properly managed; (c) identify principle risks and ensure the implementation of appropriate systems to manage these risks; (d) succession planning, including appointing, training, fixing the compensation for, and where appropriate, replacing senior management; (e) develop and implement an investor relations programme or shareholder communications policy for the company; and (f) review the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.

corporate governance standards. Among these benefits are a higher level of transparency and disclosure, improved risk management as well as enhanced control mechanisms that are able to attract more domestic and foreign investment.

The MCCG 2000 has brought some positive changes to the corporate landscape. The approach that has been adopted to increase the standard of corporate governance is both flexible and constructive in nature. It differs markedly from the traditional and conservative approach that is usually based on statute. The MCCG 2000 also set out the principles and best practices on structures and processes that companies may use to establish an optimal governance framework. At the micro-level, the reforms include the board's composition, procedures for recruiting new directors, remuneration of directors, the use of board committees, setting the mandates and activities. The prescriptive approach allows directors to focus on form, rather than exercising their judgment on what corporate governance practices are best for their companies. Investors are assumed to be able to assess the performance of the companies when there is sufficient disclosure which is reflected from a narrative statement in the annual report that explains how the companies have complied with the relevant principles. Compliance is voluntary in nature. Companies are required to give reasons for any non-compliance. In most cases, to comply with best practices, directors respond to the questions on corporate governance by merely ticking a series of boxes to show that they have complied with the prescribed best practices. Unfortunately, the prescriptive approach failed to ensure that a company has, in reality, complied with the procedures on corporate governance. The MCCG 2000 is applied on a compliance basis where the KLSE requires a listed company to disclose whether it has complied with the Code.

Multiple regulatory regimes are involved in the effort to strengthen corporate governance framework. The MCCG 2000 is supported by the Capital Market Master Plan (the 'CMMP') and the Financial Sector Master Plan (the 'FSMP'). The CMMP recommended that companies mandatorily disclose the state of compliance with the MCCG 2000. It duly recognised that good corporate governance is vital to promote a positive environment for investors. On the other hand, the FSMP aimed to develop a more resilient, competitive and dynamic financial system with a particular focus on promoting shareholders' and consumers' activism, regulatory control, and priority sector financing.

IV. PHASE TWO: STRENGTHENING THE CAPITAL MARKET

Since 2000, the standard of corporate governance in Malaysia has improved. The mandatory reporting of compliance with the MCCG 2000 has allowed shareholders and the public to access and determine the standards of corporate governance of public listed companies. However, the rapid development of both the local and international capital markets prompted regulators to review the MCCG 2000 to further strengthen corporate governance practices. The comprehensive review sought to further enhance the quality of the board of public listed companies.

The changes listed out in the Malaysian Code on Corporate Governance 2007 (the 'MCCG 2007') emphasised the following areas: the eligibility criteria for the appointment of directors and audit committee member; the composition of audit committees, the frequency of meetings, and the need for continuous training. [14] Executive directors are not allowed to become members of the audit committee, a step seen as promoting a more effective audit committee. The internal audit function was mandatory for all public listed companies. The board of directors became responsible for the internal audit.

The MCCG 2007 recommended a formal and transparent procedure for the appointment of new directors to the board. The board should appoint a committee of directors that consists of non-executive directors, the majority of whom are independent, with the responsibility for proposing new nominees to the board and for assessing directors on an ongoing basis. The actual decision as to who should be nominated should be the responsibility of the full board after considering the recommendations of such a committee.

The nominating committee should recommend to the board, candidates for all directorships to be filled by the shareholders or the board. In making its recommendations, the nominating committee should consider the candidates' skills, knowledge, expertise and experience; professionalism; integrity, and in the case of candidates for the position of independent non-executive directors, the nominating committee should also evaluate the candidates' ability to discharge such responsibilities/functions as expected from independent non-executive directors; consider, in making its recommendations, candidates for directorships proposed by the chief executive officer and, within the bounds of practicability, by any other senior executive or any director or shareholder; and recommend to the board, directors to fill the seats on board committees.

V. PHASE THREE: CHARTING THE FUTURE CORPORATE LANDSCAPE

In March 2012, the Securities Commission implemented the Malaysian Code on Corporate Governance 2012 (the 'MCCG 2012')[15]. This represents the third phase of corporate governance reforms in the country. It sets out the future corporate landscape of the nation in a more transparent manner. The MCCG 2012 set out broad principles and specific

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14 Securities Commission Malaysia, "Malaysian Code on Corporate Governance (Revised 2007)", Securities Commission, Kuala Lumpur, 2007. Also available on line at - http://www.ecgi.org/codes/documents/cg_code_malaysia_2007_en.pdf. Site accessed on 3 June 2015; The MCCG 2007 reforms set out seven specific responsibilities of the board, namely, to (a) facilitate the discharge of the board's stewardship responsibilities; (b) review and adopt a strategic plan for the company; (c) oversee the conduct of the company's business to assess whether the business is being properly managed; (d) identify principal risks and ensure the implementation of appropriate systems to manage these risks; (e) succession planning, including appointing, training, fixing the compensation of and where appropriate, replacing senior management; (f) develop and implement an investor relations programme or shareholder communications policy for the company; and, (g) review the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.

15 *Ibid.* The MCCG 2012 also contains eight broad principles together with 26 corresponding recommendations. The principles and recommendations include (a) setting a strong foundation for the board and its committees to carry out their roles effectively: (b) promoting timely and balanced disclosure; (c) safeguarding the integrity of financial reporting; (d) emphasizing the importance of risk management and internal controls; and (e) encouraging shareholder participation in general meetings. It seeks to raise the standard of corporate governance to a higher level with the purpose to enable companies to face the challenges posed by rapid global economic development.

recommendations on structures and processes that companies can adopt to make good corporate governance as an integral part of their business dealings.

The objectives of the MCCG 2012 are to (a) strengthen self and market discipline; (b) promote compliance with the law and ethics; (c) promote corporate governance culture; (d) strengthen board structure and composition, and (e) set up an effective governance structure to manage risks in an appropriate manner. The MCCG 2012 advocates the adoption of standards that exceeds the minimum prescribed by regulation. Listed companies are required to explain in their annual reports how they have complied with the recommendations even though it is not mandatory for companies to observe the MCCG 2012. Nevertheless, companies are required to explain and give reasons if there is non-compliance with any of the MCCG 2012 recommendations.

The MCCG 2012 focuses on strengthening board structure and composition. It recognised the role of directors as responsible fiduciaries, effective stewards and guardians. It recommends that companies should adopt certain structures and processes that allow good corporate governance to be an integral part of its business dealings and culture.

The MCCG 2012 requires listed companies to report on their state of compliance with the MCCG 2012 in their annual reports even though compliance is voluntary in nature. It also clarifies the role of the board in providing leadership and also the enhancement of board effectiveness. It encourages companies to adopt good corporate disclosure policies. Further, it encourages companies to make public their commitment to respecting shareholder rights.

The above recommendations for reform were based on the following reasons - to further safeguard investors' confidence; develop markets that are fair, orderly, and transparent; and to ensure more consistency and equivalence of regulatory outcome.[16] The process to reform the MCCG 2000 was also prompted by the convergence of global corporate governance standards. This arises from increased cross-border activities and investment flows that in turn, has motivated many countries to adhere to international standards of corporate governance in order to attract domestic and international capital via a country's higher level of competitiveness.

The Malaysian regulators' focus on ex-ante monitoring is evident from the MCCG 2012 strategy to strengthen board structure and composition. Effective ex-ante monitoring is a better measure to reduce the problem of asymmetries of information between agents and principals. Policy makers find it more effective to establish conditions for effective ex-ante monitoring.

The reforms in corporate governance have been successful with a significant improvement in corporate accountability, transparency and board independence. To a certain extent, it has helped to reduce the agency problem with more effective monitoring and control over the opportunistic behavior of the management. The MCCG 2000 had a significant effect on the wealth of shareholders as the prices of stocks reportedly increased by about 4.8% following the integration of the MCCG 2000 into the Bursa

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[16] See Singh R.A's opening remarks at the International Corporate Governance Seminar, 6 June 2013, Kuala Lumpur. Speech available online at: http://www.sc.com.my/wp-content/uploads/eng/html/resources/speech/2013/sp20130606.pdf. Site accessed on 7 January 2016.

Malaysia Listing Rules in 2001[17]. The McKinsey's survey in 2002 showed that 82% of Asian institutional investors perceived corporate governance to be of similar importance to financial issues while evaluating which companies to invest[18].

VI. CHALLENGES TO CORPORATE GOVERNANCE REFORMS

In Malaysia, the regulatory bodies have advocated a comprehensive and rigorous approach towards corporate governance reforms. The various reforms have produced positive changes to the corporate governance landscape. Despite the encouraging changes in Malaysia's corporate governance laws, the authorities have to address some challenges to ensure that the corporate governance reforms achieve its objectives.

A. An Optimal Board Structure

The answer to the question of what is the optimal structure of the board remains elusive. Research conducted intra-country even produce contradictory results. Some of these findings showed that a large board is effective while another research within the same country showed that a large board faced numerous difficulties.[19] An optimal board structure may not deter instances of non-compliance with disclosure norms, lax enforcement of audit rules and regulations, and even success in protecting the rights of creditors and minority shareholders.

B. The Nexus Between the State and Private Businesses

In mixed economies, governments often share a large percentage of the ownership with private investors. The close nexus of relationship between the State and private businesses is also prevalent in many Asian countries where the State functions as a key player or actor in corporate governance. In this context, ownership of business equity by the government often raises the issue of a conflict of interest. This is pertinent as the State functions in the dual role of the State as a shareholder and, simultaneously, as a corporate governance regulator.[20]

Although the government has reduced direct participation and responsibilities in many areas of businesses, its presence and traditional influence remains strongly entrenched. Political intervention has resulted in the emergence of many problems associated with the political economy of corporate governance. The influence of an extensive network of politically connected companies on corporate governance practices is a significant challenge to good corporate governance[21].

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17 Effiezal A. Abdul Wahab, Janice C.Y. How and Peter Verhoeven, "The Impact of the Malaysian Code on Corporate Governance: Compliance, Institutional Investors and Stock Performance", *Journal of Contemporary Accounting and Economics*, 12/2007, Vol. 3(2), pp. 106-186.

18 *Ibid*. at pp. 106-186.

19 *Supra* n 10, at pp. 1-26.

20 *Supra* n 11, at pp. 1-20.

21 Faccio M, Masulis R and McConnell J, "Political Connections and Corporate Bailouts", *Journal of Finance*, 2006, Vol. 61, pp. 259-267.

Political connections have a significantly negative effect on corporate governance even though the evidence did not show that politically connected firms perform better[22]. In addition, regulators may lack the political will to investigate some of the corporate improprieties, as reported in China and India[23]

C. Lax Monitoring and Enforcement

The recurrence of corporate scandals and distress such as that of a major government-linked corporation, Malaysia Airlines System's RM11.7 billion debts[24], the Port Klang Free Zone, the National Feedlot Corporation, and Sime Darby, reflects questionable corporate governance practices. Concern over the effectiveness of the reforms by the government continues despite the implementation of numerous regulations and codes of governance.[25]

The involvement of the State with well-connected companies raises questions about where ultimate responsibility lies in terms of monitoring and regulating corporate abuse. The relatively weak or lax monitoring and enforcement mechanisms in turn promote a lax governance environment. This weakness does not align with the principle that corporate governance provides legal protection to the rights of both shareholders and creditors where it reduces the risks of expropriation related to asset stripping, transfer pricing, investor dilution, or diversion of corporate opportunities from the company[26]. The quality of enforcement set up by a company, and the strict adherence to securities laws by both regulators and courts are important elements of corporate governance and finance[27].

D. Protection of Investors

The protection of investors remains a constant concern among the different stakeholders. Investors' confidence is closely associated with good corporate governance. In Malaysia, there is growing concern over the decline in foreign investment during the past ten years. Between 1998 and 2008, the inflow of foreign direct investment into Malaysia have declined to an average of RM4.3 billion, compared to an average of RM5.2 billion between 1990 and 1997. Private investments have dropped from 31.2% in 1995 to 10.9% in 2008. The stock market fell by 40 percentage points during the period from July 2008 to February 2009[28].

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22 Supra n 17, at pp. 106-186.

23 Rajagopalan N and Zhang Y, "Corporate Governance Reforms in China and India: Challenges and Opportunities", *Business Horizons*, 2008, Vol. 51, pp. 55-70.

24 Anshuman Daga and Yantoultra Ngui, 25 March 2014, *"Struggling, Malaysian Airline may need Government Bailout"*, Reuters: http://www.reuters.com/article/us-malaysia-airlines-financing-idUSBREA2O1U420140325. Site accessed on 2 May 2015; As of December 2013, Malaysia Airlines System's total debt amounted to 11.7 billion ringgit.

25 *Supra* n 11, at pp. 1-23.

26 *Supra* n 8, at pp. 3-20.

27 La Porta R, Lopez-de-Silanes F, Schleifer A and Vishny R, "Legal Determinants of External Finance", *Journal of Finance,* 1997, Vol. 52, pp. 1131-1159; La Porta R, Lopez-de-Silanes F, Schleifer A, and Vishny R, "Law and Finance", *Journal of Political Economy,* 1998, Vol. 116, p. 1113.

28 *Ibid.,* "Legal Determinants of External Finance", at pp. 1131-1159.

E. Quality of Disclosure

The quality of corporate disclosure continues to be a challenge. A study by Todd showed that, firms with a higher disclosure quality tend to have a significantly better stock price performance.[29] The study among 398 companies from Indonesia, Korea, Malaysia, the Philippines, and Thailand revealed that firm-level differences in variables related to corporate governance had a strong impact on the firm's performance during the East Asian financial crisis of 1997–1998. Significantly better stock price performance is reported to be associated with firms that had indicators of higher disclosure quality (ADRs and auditors from Big Six accounting firms), with firms that had higher outside ownership concentration, and with firms that were focused rather than diversified. The results suggest that individual firms have some power to preclude expropriation of minority shareholders if legal protection is inadequate.

F. The Rights of Shareholders

In terms of shareholder rights, it is notable that the amended Listing Requirements in Malaysia prevent companies from imposing restrictions on proxy appointment by shareholders. In addition, the amendment to allow a registered shareholder to appoint multiple corporate representatives is significant. Nevertheless, the function of the two-proxy rule is not clear since a standard and uniform rule that relates to the name to be registered in the shareholder register has yet to be introduced. The question that arises is whether the name of the beneficial owner should be the beneficial owner or the trustee[30].

There are other obstacles that prevent equitable treatment and enforcement of shareholders' rights. Corruption, political interference, discrimination, and inaction are some of the common barriers to foreign investment. Some countries have set up special courts to enhance the enforcement of shareholders' rights. In Malaysia, five Sessions Courts and three High Courts seem to be effective, to some extent, in strengthening the enforcement of shareholders' rights as the courts deal with commercial and capital market cases. An enforcement division in the Kuala Lumpur Stock Exchange has also been set up to enhance enforcement capacity.

G. Institutional Investors' Activism

Traditionally, the level of activism among local institutional investors remains at a relatively low level even though the authorities provide strong support to promote more active participation. The MCCG 2012 recommended the establishment of a new code for institutional investors and the setting up of an umbrella body for institutional investors.

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29 Todd M, "A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis" *Journal of Financial Economics*, 2002, Vol. 64, pp. 215-268.

30 Asian Corporate Governance Association, "Response to the 'Corporate Governance Blueprint'", December 2011. At http://www.acga-asia.org/public/files/ACGA%20Response%20to%20CG%20Blueprint%20(final%20draft).pdf. Site accessed on 25 April 2015.

This is useful as it allows institutional investors to participate more actively in corporate governance rather than adopting a "voting by feet" approach.

H. Ownership of Companies

Although it is mandatory to separate the position of the chairman and the Chief Executive Officer, the majority of listed companies in Malaysia tend to be either family-controlled or State-owned. Thus, it is a challenge to have an independent chairman who is loyal to the majority stakeholder. The question is whether the new Code is feasible as unit trust fund managers, government fund managers, and other fund managers often tend to lobby against each other[31] .

I. International Best Practices

The Malaysian regulators have also actively participated in the Asian Roundtable meetings and have committed themselves to comply with the OECD Principles and best practices. It recognised that weak corporate governance can lead to economic and financial vulnerabilities. It has followed its other Asian neighbours in placing significant efforts to strengthen the laws and regulations, define shareholder rights and improve shareholder engagements. Although regulators may examine and even adopt universal corporate governance principles and best practices, the intricacy that prevails usually requires the contextualisation of the corporate governance framework to accommodate domestic need and demands.

J. Business Culture

The geo-diversity of business culture and cross country differences means that different approaches are needed to overcome problems related to corporate governance. Unfortunately, some policy makers continue to apply the 'one-size-fits-all' solutions while past research recognised cross—country differences required different strategies.[32] The European Union countries have different levels of economic, financial, and social development. Unfortunately, the European Union authorities sought to impose uniform rules in dealing with corporate governance policies[33]. Policy makers seem to ignore the specific characteristics of individual countries. In this context, the Malaysian regulators need to exercise caution to avoid problems associated with the adoption of the 'one-size-fits-all' approach.

K. An Improved Corporate Landscape

Generally, the Malaysian corporate landscape has experienced some positive changes due to the authorities' active commitment in the implementation of a strong corporate

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31 *Ibid.*
32 *Supra* n 9, at pp. 236-260.
33 *Ibid*.

governance standard. The authorities have often sought guidance from the Principles of Corporate Governance set out by the OECD to maintain a high standard of corporate governance[34]. The country continued to place corporate governance as a priority and a core component in its strategic plan for the development of the capital market[35]. It has also signed the International Organization of Securities Commission's Multilateral Memorandum of Understanding to participate in cross-border enforcement and international collaboration via the exchange of information among regulators such as information related to beneficial ownership and control structures[36].

In terms of strengthening the quality of auditing, the Securities Commission in Malaysia has established the Audit Oversight Board to empower securities regulators and the KLSE to improve enforcement. Malaysia strives to adhere to the IOSCO's recommendations to establish an independent body to enhance the quality of the audit system. In 2007, Malaysian auditors who resigned are required to disclose the reasons for resignation or removal from office to the regulators.

The establishment of board committees is mandatory for listed companies by law, regulation, or listing rules. In Malaysia, board committees consist of a majority of independent directors. The requirements regarding the number of independent board members on audit committees are different among Asian countries. In Malaysia, they have to consist of at least a majority of the independent board members.

Corporate governance reforms in Malaysia appear to focus on internal mechanisms. The reforms stressed on the responsibilities of directors and management, and the need to promote disclosure. However, effective governance is also determined by the existence of an efficient external institutional framework that comprises the regulatory, legal, and financial frameworks. Although the focus is mainly on the internal governance mechanisms, there is a need to ensure that there is strong support from the external mechanisms, namely, the courts, and the institutional investors. In addition, the internalisation of good corporate governance culture incorporates good business management practices that are supported by moral and ethical values. Under such circumstances, regulatory discipline would, perhaps be less critical.

VII. CONCLUSION

Three major waves of regulatory changes entered the market as a response to enhance corporate governance practices in Malaysia. These reforms focused on improving and promoting a culture of good corporate governance with an enhanced market discipline and the creation of more shareholder value. The reforms aimed at reducing corporate scandals in the future. Concerted efforts and commitment to enforcement are vital to

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34 The Organisation for Economic Cooperation and Development (OECD), "Reform Priorities in Asia: Taking Corporate Governance to a Higher Level", Asian Roundtable on Corporate Governance, 2013. Available online at: http://www.oecd.org/daf/ca/49801431.pdf. Site accessed on 26 May 2015.

35 *Supra* n 16.

36 Securities Commission Malaysia, "Compliance with IOSCO Principles". Available online at: http://www.sc.com.my/general-section/international/compliance-with-iosco-principles/. Site accessed on 20 May 2015.

achieve success otherwise the reforms would, at best, be characterised by, sporadic knee-jerk reactions by the regulators and appears to be superficial in nature.

Corporate governance reform must also circumvent the factors related to the lack of transparency, an unwillingness to accept global best governance practices, adherence to governance rules that are opaque and the traditional strength of a culture of relative secrecy in companies that are predominantly family-controlled. Otherwise, significance governance lapses in practice would continue despite the plethora of reforms in rules and regulations. These obstacles would outweigh the efforts of the regulators to establish a climate of greater accountability and transparency[37]. The transition from a closed, opaque, and relationship- based governance system to a more open, transparent, and rule-based governance system is indeed a formidable challenge.

[37] Mohd Ghazali N.A and Weetman P, "Perpetuating traditional influences: Voluntary disclosure in Malaysia following the economic crisis", *Journal of International Accounting, Auditing and Taxation*, 2006, Vol. 15, pp. 226-239.