

# **WINNING WAYS OF A GLOBALISED CORPORATE GOVERNANCE**

**By: Vijayaraj R Kanniah**

**[Consolation Winner – General/Professional Category]**

**The Malaysian Association of The Institute of Chartered Secretaries and Administrators**

**National Essay Competition on Corporate Governance 2003**

The financial crisis that hit South East Asia since July 1997 has placed enormous pressure on Malaysia's fragile economy. The crisis crippled various part of the economy which includes financial institutions that practiced "easy credit" policies which eventually translated into large loan losses. Most Banks in Malaysia suffered huge losses due to huge corporate failure. The crisis shattered investors confidence who perceived that Malaysian companies have too much easy money, crazy diversification, over expansion, weak supervision, crony capitalism and over heating of the economy.

The crisis drew further negative perception towards Malaysia for being the "haven" for counterfeit credit cards and currency, phone cloning, copy right infringements, bookies haven, poor politics and the lack of civic consciousness and manners.

Furthermore, the financial crisis opened "a can of worms" which revealed that one of the vital structural weakness identified in our corporate sector is the lack of Corporate Governance. Corporate Governance refers to the way the company is governed and controlled. It reflects "check & balance" to ensure minimal abuse of power by those in control of the company and protection of public shareholders fund i.e. public listed companies.

The Finance Committee Report On Corporate Governance defined "Corporate Governance as the process and structure used to direct and manage business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value, whilst taking into account the interest of other stakeholders".

Many may ask, do we really need Corporate Governance? The answer is a sure yes if we want to strengthen Corporate Governance practice in Malaysia and ultimately return investors confidence in Malaysia. Investors whether local or foreign are echoing for good Corporate Governance to prevent abuses of power by those in control of the company. It is also to ensure that shareholders are aware of what exactly is going on in the company. In addition, a strengthen Corporate Governance will protect public shareholders fund particularly with public listed companies.

Many analyst and critics have posed the question on how to strengthen Corporate Governance practice in Malaysia and where do we look for precedents? Well, Corporate Governance is not a new practice since it has emerged in the United Kingdom way back in the 80's and early 90's Corporate Governance in United Kingdom was born through huge corporate scandal that rocked the British's corporate world, with the biggest being the downfall of Barring's Bank in the mid 1990's. The 233 year old Bank is the oldest Merchant Bank in Britain but collapsed after Nick Leeson, its General Manager at Barring Future (Singapore) lost substantial amount of money under a hidden account which reflects the lack of transparent transactions. Further scandals such as the Robert Maxwell Corporation downfall, mismanagement in Pollypeck Corporation and British Airways and excessive director's remuneration in Guinness Plc fuelled the need for change to protect large number of capital providers. The capital providers includes shareholders, debenture holders, loan creditors and trade creditors.

In the United Kingdom, Corporate Governance has been strengthened through three important stages. In 1992, Sir Adrian Cadbury introduced the Cadbury Code as there was a need for increased disclosure mechanism aimed at all directors in United Kingdom's public listed companies. The "Code of Best Practice" inter alia recommended that the Board of Directors should have a separate CEO and Chairman. It also raised a need for non executive directors to bring independent judgement into the company while covering the issue of service contract and remuneration. Emphasis was also given to the need to have an effective audit committee.

In 1995, Sir Richard Greenbury submitted the Greenbury Report On Directors Remuneration which was a problematic area which lead to the "fat cat debate" on excessive remuneration to directors. The main proposal among others recommended that the remuneration committee should only be independent non-executive directors, Annual Reports on directors remuneration be approved at Annual General Meetings with a full disclosure on directors remuneration including all other benefits.

Finally, in 1999, Sir Ronald Hampel presented the Hampel Report On Corporate Governance. The report is basically a review of Cadbury and Greenbury Report and it had no substantial change as compared to the two previous report. Nevertheless, the report provided the stock exchange with set of principles and code (incorporating the recommendations of the Cadbury and Greenbury Report) known as "Combined Code". In addition, listed companies are required to state in their Annual Report and accounts, the extent to which they have applied the principle and provisions on Combined Code.

In making references to United Kingdom's experience in strengthening their Corporate Governance, there is a strong need in Malaysia to reinvent the corporate enterprises to efficiently meet emerging global competition which will be market oriented. Malaysia needs to prepare itself for globalization, global competition and the precedent set by global practice, the step to

strengthening Corporate Governance resulted in The Finance Committee Report On Corporate Governance, February 1999 and Malaysian Code on Corporate Governance, March 2000.

The Malaysian Code On Corporate Governance was launched on 25 March 1999 by the Ministry of Finance. Its salient features inter alia encourages disclosure, maintain a balance between statutory regulation and self regulation with the backing of KLSE listing rules. The code has two main parts, Part 1 sets the broad principle of good governance in Malaysia and public listed companies have to disclose under listing rules annually a narrative account on how they have applied the principles to their structure and processes. Part 2, sets out the best practice for public listed companies to follow. Public listed companies must explain under listing rules circumstances justifying departure from such practices.

On compliance of the Malaysian Code of Corporate Governance, the Kuala Lumpur Stock Exchange can impose sanctions for non-compliance under Section 11 of the Securities Industry Act 1983. In addition, the Securities Commission will also grade companies under the merit – demerit scheme. However, a big role for compliance must be played by the rating agencies. Rating Agency Malaysia Bhd (RAM) and Malaysian Rating Corporation Bhd (MARC) must rate the companies accordingly and down grade them if they are found to be not in compliance of the Malaysian Code of Corporate Governance. Hence, if all parties play their role well then companies have no choice but to comply to Malaysian Code on Corporate Governance or face the punishment rendered by relevant parties.

In order to strengthen the implementation of Corporate Governance in Malaysia, we must identify what Corporate Governance is trying to built in every company. Corporate Governance is essentially about leadership. One may ask what kind of leadership are we talking here?

Leadership can be divided into four categories:

#### 1. Leadership for efficiency

Malaysian companies have long been identified to be wasteful and not being productive and efficient in the usage of materials and on the economies of scale. Efficiency is essential if the company wants to upgrade itself to be a world class player and to be able to complete in a globalised environment.

#### 2. Leadership for probity

Probity basically means being honest and telling the truth A clear example of poor ethics among Malaysian corporate citizen is Datuk Ishak Ismail who was charged in the courts recently for submitting false information to the Securities Commission. If Malaysian corporate personalities were to continue in this manner then our Stock Exchange is heading for greater disaster as

investors love honesty and dislike any type of manipulation. Leadership for probity has to be created in order safeguard the interest of all parties especially public shareholders who are easily misled by any sensitive information.

### 3. Leadership With Responsibility

All corporate citizen especially directors must bear the responsibility in decision making. All decision made has to be accounted for. Directors must not cultivate the habit of “washing hands” when wrong decision are made. In the western corporate world, we have witnessed many corporate leaders stepping down from their position when wrong decisions are made Vice versa the same should be applied here. Unfortunately, despite the financial crisis that hit several big corporate players who made wrong decisions such as over exposing themselves in the property sector, no leaders stepped down from their position instead they continue to lead the Group and no punishment were thrown at them for the mistake done. How can this be? Are we on at the right path towards having leaders with responsibility?

### 4. Leadership Which Is Transparent & Accountable

Leadership needs to be transparent and accountability must be there in order to convince investors that the company is worth the investment that is being made. Corporate governance is all about transparency and accountability. Decision that are being made and any of the transactions entered by a company need to be revealed either through an announcement through Kuala Lumpur Stock Exchange or in the Annual Report. All types of risks that is associated with the company can only be properly considered if all information are revealed so that an investor can make a decision based on the information that he or she has.

Corporate Governance will only be effective if it is implemented and the question that everyone will be asking is who will be responsible in implementing it? Is it the responsibility of the Board of Directors of the companies or does it solely fall on the regulating agencies. Well, to be fair everyone plays a role in strengthening and implementing Corporate Governance in Malaysia. Shareholders being the ultimate owners of the company play a vital role in enforcing Corporate Governance. Firstly, all shareholders must educate themselves to understanding what is Corporate Governance and once they have a good understanding of it, shareholders can check on the compliance of their invested company in Corporate Governance. If it is found that the company does not adhere to proper governance then the shareholder may sell the stock, which may result in price dilution. This is one way to punish the company for its failure to follow good Corporate Governance.

Directors must also play a role in implementing and strengthening Corporate Governance beside it being a shared responsibility for governance, regulating agencies, professional bodies and standard setters. Everyone has to play a role to ensure the success of Corporate Governance.

Hence, if it is implemented by everyone then non-listed companies will also train themselves to have good Corporate Governance.

In strengthening Corporate Governance, many laws, rules and regulations are being introduced from time to time to ensure that companies that are breaching good Corporate Governance are being punished. Among them are Companies Act 1965, Securities Industries Act 1983, Banking & Financial Institution Act, 1989, Insurance Act 1996, Securities Commission Act 1993. KLSE Listing Requirements and Practice Notes, Financial Reporting Act 1997, Penal Code, Anti Corruption Act and other forms of law reforms that are being looked into by the government.

However, the quickest way to strengthen Corporate Governance is to ensure that directors discharge their duties diligently. The four main duties of a director are listed as follows:

#### 1. Duty of skill & care

Directors that are appointed to maintain the smooth operations of the company must be capable individuals with the right qualification and experience. They must have reasonable skill and must give their full attention to the affairs of the company. There has been numerous reports of directors having far too many directorship, hence, making it difficult for them to give their best to the company. Directors must also ensure that there is proper delegation to ensure that the workload is shared and the knowledge is being transferred for the improvement for the company. The duties of skill and care of the Directors are owned only to the company itself and not to the individual members.

#### 2. Fiduciary Duty

On fiduciary duty, directors must ensure the 3 main duties of good faith is adhered by them. At all times the directors in discharging their duties, must ensure that it is a bona fide transactions where it is genuine with honest intentions. Therefore, directors have a duty to act in the best interest of the company, its present and future shareholders and its employees, customer and suppliers. Legally the interest of the company represents those of the present and future shareholders generally, irrespective of class.

#### 3. Statutory Duties Of Directors

Statutory duties of directors is basically governed by Companies Act, 1965. The Act requires directors to give adequate disclosure of information to creditors and shareholders to enable them to make an intelligent appraisal of the rewards and risk related to investment and business dealings made on a particular company.

#### 4. Management Duties Of Directors

On management duties, a directors must remember that the management of a company is in the interest of the shareholders and it is agreed upon in the Articles of Association that the

management be delegated to the Board of Directors as required by the Companies Act, 1965. Almost all management powers of directors are stipulated in the Articles of Association.

As discussed, we have learned from the experience in United Kingdom and with this experience we should be able to form our own framework in strengthening Corporate Governance in Malaysia. The Finance Committee Report On Corporate Governance and the Malaysian Code on Corporate Governance should form the “backbone” on our preparation to strengthen Corporate Governance in Malaysia.

The framework for Corporate Governance and best practice recommended by the Malaysian Code should be implemented fully. The Malaysian Code aims to set out best practices on structure and processes that public listed companies may use. If the code is followed accordingly by the public listed companies then our level of Corporate Governance will be enhanced and we will be moving another step in forward in our quest to strengthen Corporate Governance in Malaysia. It has been the desire of the Securities Commission and Kuala Lumpur Stock Exchange that all public listed companies either in the Main Board or in the Second Board will implement the Malaysian Code of Corporate Governance in their companies and directly support good Corporate Governance. Hence, if this is achieved then we can see the return of foreign investors into our country thus boosting our stock market and hopefully the stock market would not be so bearish anymore.

Nevertheless, it is good to note that certain amendments has been made to the Securities Industry Act 1983 in 1998 to promote higher level of Corporate Governance among listed companies in Malaysia. A clear example will be Section 11 of Securities Industry Act 1983 where it has been expanded to include directors, substantial shareholders and officers apart from public listed companies to be under an obligation to comply with Kuala Lumpur Stock Exchange listing requirements. A breach under this Section will draw an increased penalty from RM250,000 to RM1.0 million. This move should be applauded as the expansion in Section 11 will create more awareness in directors and substantial shareholders that they are not out of the hands of law and a penalty of RM1.0 million will be a painful experience for them.

Further to the above, Section 100 of the Securities Industry Act 183 inter alia provides that directors acting in breach of Kuala Lumpur Stock Exchange Listing Requirement will provide the Kuala Lumpur Stock Exchange power to apply to the courts for an order to remove such directors and bar him from acting as a director for any listed company for such period as determined by the courts. This is a powerful tool for Kuala Lumpur Stock Exchange and it can be used in a very effective manner to deter directors from doing anything that they wish. Section 100 will also be a test for Kuala Lumpur Stock Exchange on their willingness to use it to remove directors and it will be a interesting precedent to set in our courts.

Besides Section 11, Section 122B of Securities Industry Act will also provide the punishment in our quest to strengthen Corporate Governance. The Section states that any false or misleading statements given to the Stock Exchange or Kuala Lumpur Stock Exchange can amount to an offence if done with intent and knowledge. One of the well known individual that was charged under this Section was KFC Executive Chairman, Datuk Ishak Ismail for submitting false information to the Securities Commission. The act charging Datuk Ismail in the courts opened the eyes of many corporate players. They now know that the regulators are more than willing to take action and the days where corporate players repeatedly break the law are gone and the regulators are going down hard on any breach of the existing laws.

The act of amending and enforcing the law in our journey to strengthen Corporate Governance will go a long way. Corporate players are businessman who will break any rules in order to make money. However, with the laws surrounding them, corporate players will now be more cautious and will not blindly make decisions for fear of the law catching up on them. The laws are vital to ensure that good Corporate Governance are followed and the failure to do so may lead to severe punishment under the law.

One of the essential tools in strengthening Corporate Governance is transparent accounts reported in the Annual Report. The Financial Reporting Act 1997 was born to establish Financial Reporting Foundation and Malaysian Accounting Standards Board. The Malaysian Accounting Standard Board functions include issuing new accounting standards, review, revise or adopting existing accounting standard as approved accounting standards and issuing statements of principle for financial reporting. This move is healthy as public listed companies have to adhere to the standards set by the Malaysian Accounting Standard Board and cannot dictate their own accounting policy. This hinders manipulation of accounts and will be more transparent and trust worthy for investors to rely on the numbers reported by the company.

Besides all this actions, Kuala Lumpur Stock Exchange should not relax but further step up its effort against public listed companies towards greater compliance on the Kuala Lumpur Stock Exchange Listing Requirements. The push forward will surely encourage public listed companies to practice good Corporate Governance. The move to transfer financially distress companies into Practice Note 4 status should be applauded as the move removes doubts among investor on whether to invest in this companies. Investor especially the small players always get caught by rumors and end up investing in companies who are in financial trouble and are in the final stages of doing a capital reduction. The move to Practice Note 4 status removes all doubt and all investors are well aware that the companies are in a bad condition and it is not worth investing at the current stage. This in a way will discipline the company to come up with a restructuring plan and to do the restructuring in a fast pace in order to remove itself from Practice Note 4 status.

Kuala Lumpur Stock Exchange and Securities Commission have to play an important role in enforcing the listing rules. The breach of Kuala Lumpur Stock Exchange Listing Requirements lead to actions taken against a total of 28 public listed companies from 1.10.1998 to 31.12.1998

and another 6 from 1.1.1999 to 10.2.1999. The sanction range from private reprimand to a fine of RM100,000. Maybe, both Kuala Lumpur Stock Exchange and Securities Commission should be more active in reprimanding companies that breach the listing requirements. A more active and brave role shown by the regulators will surely scare the listed companies as every move that they make are being watched closely by the regulators. The regulators should beef up their manpower in this area and be very focus on listed companies activities to ensure that Corporate Governance is strengthen. If the needs arises, the fines should be increased as some companies feel that the payment of fine is small and they would rather pay the fine than follow the regulation.

One of the engine in strengthening Corporate Governance is “transparency”. The Kuala Lumpur Stock Exchange Listing Requirements contains a Corporate Disclosure Policy which sets out the obligation of public listed companies with regard to corporate disclosure (timely, accurate and adequate disclosure). This policy is important as most public listed companies do not adhere to this policy as sensitive information may have a huge influence on the price of their stock. Some listed companies practice “delay tactics” in order to gain on the sensitive information. This is totally unfair to investors who depend on timely disclosures in order to make decisions on their investments. On the other hand, some listed companies do not disclose losses incurred or legal suits faced by them for fear that their stocks would be dumped by investors if investors are informed of any outstanding suits and the amount that is involved. The Corporate Disclosure Policy should be closely monitored by public listed companies and the failure to do should be quickly reprimanded.

Another area where Corporate Governance can be strengthen is on related party transactions. The recent amendments to Part 4 and Part 5 of Kuala Lumpur Stock Exchange Main and Second Board Listing Requirements is to further strengthen provision on related party transactions. Transactions involving interest of directors or substantial shareholders of public listed companies and person connected to such directors or substantial shareholders can be curbed more effectively under the new Part 4 and Part 5. Since the Stock Exchange started, we have seen many listed companies tying contracts with related parties. Directors or past owners who have cashed out by listing the company still insist on making more money by giving contracts to their related parties. The contracts entered may not be in the best interest of the company i.e. the price could be too high but being related parties, the contracts will be forced onto the company. At the end, the company will be on the losing end for the gain of certain related parties. One may ask why amend Part 4 and Part 5 of Listing Requirements? The answer is simple, to ensure that minority interest are safeguarded and to enhance the overall framework for good Corporate Governance.

Among the major changes are widening the scope the include transactions between public listed companies and person connected to a director or substantial shareholder and parties in which director, substantial shareholder or any person connected with the director or substantial shareholder has an interest.

The amendment will surely enhance disclosure in respect of related party transactions besides prohibiting a director, substantial shareholder or any person connected to the director or substantial shareholder with any interest, direct or indirect in a transaction from voting in any resolution to approve such transactions.

The amendment also requires appointment of an independent advisor to advise the shareholders on the transaction. The independent adviser is considered an important step to protecting minority shareholders who are always left in the dark and are unaware of the activities of the company. In the past, major acquisition or disposal are not made known to all shareholders and the impact of such acquisition or disposal are not properly advised. Hence, this move on the appointment of an independent advisor will draw a better picture to shareholders and they would be able to make a better decision based on the information that are given to them.

On another note, a new code on Take Overs and Mergers came into force on 1<sup>st</sup> January 1998 pursuant to the Securities Commission Act 1993. The Take Over and Merger code was implemented to ensure that majority shareholders are given a fair opportunity to consider the merit and demerit of a take over offer and enable them to decide whether to retain or to dispose their shares. This is to ensure higher standard of disclosure and Corporate Governance.

The major weakness in strengthening Corporate Governance is on the level of education of the directors in public listed companies. Some directors grew up purely on business and lack proper ethics. The decision made by these directors may be in line with the way they do business but it may be wrong and an act of breach of the Listing Requirements may have been triggered. Who is to be blamed for the low level of education of these directors? In line with this problem, Kuala Lumpur Stock Exchange in July 1998 embarked on an educational programme for directors on the obligation of public listed companies under Kuala Lumpur Stock Exchange Listing Requirements. These educational programmes should be taken seriously by the directors who are attending it. If the attitude of the directors attending the programme is purely for formality then the objective of the educational programme will fail. Hence, the problem of ignorant directors will not be solved and the Kuala Lumpur Stock Exchange Listing Requirement will continue to be breached. It is hoped that these educational programmes succeed in order for Corporate Governance to be strengthen in Malaysia. Only with a strong Corporate Governance can we attract investors whether local or foreign to return to our stock market which is hungry for new investment and new direction towards a “bull” market.

On financial reporting, these area had in a certain way moved forward and it is a good sign for better Corporate Governance. Currently, all public listed companies must file financial statements with the Kuala Lumpur Stock Exchange for public release on a quarterly basis. The quarterly report comprises Income Statements, Balance Sheet and Explanatory Notes. This move will surely strengthen Corporate Governance as the quarterly reporting is considered more transparent. Previously, investors have to wait for the half yearly financial announcement which

may take just too long and it may be too late for an investor to make timely decision. Now, investors can act quickly with financials being reported every quarter. Not just the investors benefits from this quarterly reports. Bankers who are very keen in the financial performance of their Borrower can now keep a closer watch on the companies. Quarterly financial reporting would also give little room for companies to manipulate the accounts.

As time passes by and with the experience gathered globally, it is time for Kuala Lumpur Stock Exchange to revamp its Listing Requirements. The revamp will surely enhance Corporate Governance amongst listed companies. In addition, it will also to strengthen the protection accorded to the investing public. The Listing Requirement should be updated to ensure that further good Corporate Governance can be implemented.

Based on the above discussions on ways to strengthen Corporate Governance and the experience in United Kingdom, one may ask whether we are at the right path to towards the winning ways of a globalised Corporate Governance. The most important way to move forward in Corporate Governance is the willingness of our listed companies to follow the Malaysian Code On Corporate Governance. Another important step is for the listed companies to make their own steps to further strengthen Corporate Governance in their organization. The Kuala Lumpur Stock Exchange and the Securities Commission should continue to reward the companies that implement good Corporate Governance besides exposing the companies that practices bad Corporate Governance. Actually the biggest reward for a company in pursuing good Corporate Governance is the attraction of more investors which will see a huge surge in the price of its stocks.

Regulators in Malaysia must not fear to punish the companies that continue to breach listing requirements. A good example is Rekapacific which has been the talk of the country that the company would be de-listed but todote the battle continues between the regulators and the company in their pursuit to de-list the company. A precedent has to be set on these Practice 4 status companies that take no step to regularize themselves. Regulators should show more serious intents if they wish to strengthen Corporate Governance in Malaysia. Corporate players will always look for loop holes and delay tactics to get themselves around the rules and the law. In such circumstances, the regulators should be more vigilant in executing their task and ensure that proper actions are taken for any breach without any fear against any individual or organization.

In conclusion, the whole world has admitted that Corporate Governance is the way forward for companies to progress and for investors to prosper. The stronger the Corporate Governance, the healthier is the country's stock exchange. One has to admit, investors love good Corporate Governance as it ensures that their investment is safe and transparent. The Malaysian

government through various regulators have pushed hard to enforce good Corporate Governance in Malaysian companies. Even though there are some progress in adopting good Corporate Governance in Malaysia, the pace set remains slow and the regulators must push harder to enhance Corporate Governance and win the hearts of investors. Everyone from directors of the company to investors have a role to play towards ensuring better Corporate Governance. All parties must be involved if Corporate Governance is to succeed. No matter how much effort that is being put in, all parties must never forget that Corporate Governance is too valuable and represents a “vital tool” to put pressure on the management of a company and it remains a right step to bring back investor’s confidence.