CORPORATE GOVERNANCE IN MALAYSIA

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Introduction

This article examines the corporate governance system in Malaysia. A sound corporate governance system should help create an environment conducive to the efficient and sustainable growth in the Malaysian corporate sector.[1] Since the Southeast Asian financial crisis in 1997 – 98 ('financial crisis'), corporate governance has become a key policy issue confronting many Southeast Asian countries, including Malaysia. This article considers the distinctive problems of corporate governance in Malaysia, despite several steps for reform that have taken place since the financial crisis. There will be a brief discussion on the meaning of corporate governance and an overview of the present status of corporate governance in Malaysia, in particular after the financial crisis. Then, this article will consider four areas which appear to be distinctively problematic in the Malaysian corporate sector. These are, first, the ownership structure, composition and operation of Malaysian companies and conglomerates in Malaysia. Second, the nature of shareholder control and protection made available in the Malaysian corporate sector. Third, relevant issues involving creditor monitoring, discipline and protection provided in the Malaysian corporate sector, and fourth the status of Malaysian media businesses. The areas mentioned above play a crucial role in creating a sound corporate governance system, and significant steps for reform have taken place pertaining to these areas. However, there are still certain distinctive characteristics in the nature of the Malaysian corporate sector which require further scrutiny in order to improve the corporate governance system in the country.

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1 J Zhuang, D Edwards, D Webb and MV Capulong, 'Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines and Thailand' (2000) 1 *Asian Development Bank* Volume 5.

Meaning of Corporate Governance

Sometime in 1998, the Malaysian government purported to establish a High Level Finance Committee ('the Committee') to look into establishing a framework for corporate governance and setting best practices for the Malaysian corporate sector.[2] According to the Committee in their Report on Corporate Governance 1999 ('the Report'), corporate governance is defined 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 interests of other stakeholders.[3]

The process and structure referred to above defines the division of power and accountability among shareholders, the board of directors and management, and its impact on other stakeholders such as employees, creditors including customers and suppliers, and the community at large.[4] The Committee acknowledges that the business and affairs of every company must be directed and managed, and that the structure and process of directing and managing should be governed by a set of rules.[5] The structure for corporate governance is created by legal and administrative frameworks found within the operation of companies, and includes the companies' legislation, listing rules, the companies' memorandum and article of association, resolutions of the board of directors and shareholders, relevant laws of general application and community standards.[6] The principles of corporate governance laid down by the Committee reflects several principles expounded by the Organisation for Economic Cooperation & Development (OECD), the Asian Development Bank (ADB), the World Bank and other corporate governance committees from the United Kingdom, Australia and other common law and non-common law countries.

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2 Report on Corporate Governance February 1999, High Level Finance Committee on Corporate Governance of Malaysia, at page ii.

3 Ibid, 52.

4 Philip T.N. Koh 'Principles, Practice and Prospects of Corporate Governance: The Malaysian Legal Framework' [1998] *I.C.C.L.R.*, Issue 10, 291.

5 Report on Corporate Governance February 1999, High Level Finance Committee on Corporate Governance of Malaysia, 53.

6 Ibid.

The Status of Corporate Governance in Malaysia

Corporate governance in Malaysia has received much criticism in recent years since the failure of numerous companies during and after the financial crisis.[7] The financial crisis,

> generated a substantial amount of analysis and debate largely focussed on macro-economic issues, systemic stability as well as issues pertaining to the regulation of international investors, the role and function of regulators and the need to improve disclosure and the governance system.[8]

This crisis highlighted weaknesses in corporate governance in Malaysia, which led to efforts to rectify and overhaul the entire corporate sector in Malaysia.[9]

According to Michael Backman, there must be basic rules to create good and efficient corporate governance systems. These basic rules will form an underlying groundwork for the Malaysian corporate governance system, *inter alia*, as follows:-

- effective standards of corporate governance to ensure that managers and controlling shareholders do the right thing;
- a high degree of corporate transparency and adequate external auditing;
- efficient stock exchanges;
- markets that are either competitive or under the constant threat that they might face real competition;
- legal frameworks that are efficient and transparent, with judicial systems to enforce the rules credibly and without favour;
- there must be a clear distinction between regulators and the regulated;
- banking systems that are independent, transparent, and competitive; and
- a well-resourced, inquisitive, and independent media.[10]

Malaysia has taken several active steps in improving its corporate governance system from 1995 onwards. Major reforms resulted in the establishment of the Committee in 1998 and the release of its Report in March 1999. Further, the implementation of the Committee's recommendations resulted in significant amendments to the Listing Requirements of the Kuala Lumpur Stock Exchange

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7 B. Chia 'Corporate Governance: Malaysia' (Jan 2001) 31 *Asia Business Law Review*, 42.

8 Report on Corporate Governance February 1999, High Level Finance Committee on Corporate Governance of Malaysia, at page ii.

9 Chia, above n7, 42.

10 M. Backman, *Asian Eclipse – Exposing the Dark Side of Business in Asia* (2001), Revised Edition, 2.

(KLSE), the introduction of the Code of Corporate Governance and the establishment of a mandatory accreditation programme for company directors.[11]

This article canvasses on several issues that are problems in the Malaysian corporate governance system and discusses the reforms that have been implemented in order to improve the Malaysian corporate governance system. Further, this article considers the ongoing problems faced by the corporate sector despites such reforms.

Overview of The Distinctive Problems in the Malaysian Corporate Governance System

According to a study conducted in November 1998 by the Asian Development Bank (ADB), *'A Study of Corporate Governance and Financing in Selected Developing Member Countries'* ('ADB Study'), there are several factors led to Malaysia and other Southeast Asian countries to face severe problems with their economies and corporate sectors during the financial crisis.[12] These factors include the ineffective board of directors, weak internal controls, poor audits, lack of inadequate disclosure and lax legal enforcement characterised in corporate governance in many Southeast Asian countries.[13] It is recommended in the ADB Study that a good corporate governance system should consist of:-

(i) a set of rules that define the relationships (including respective rights and responsibilities) between shareholders, managers, creditors, the government and other stakeholders; and
(ii) a set of mechanisms that help directly or indirectly to enforce these rules.[14]

It is submitted that distorted governance structures led to the financial crisis in most Southeast Asian countries including Malaysia.[15] Further, the standards of corporate governance were poor in these countries characterised by conduct such as petty bribery, favouritism, and corruption.[16] There is prominent 'economic tribalism' with the most prominent 'tribe' being the overseas Chinese population. Business environments that are not governed by sound legal systems and have poor investor protection tend to have more personal connections and relationships

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11 G. Shenoy and P. Koh 'Corporate Governance in Asia: Some Developments' *Asia Law Review* (31) (January 2001) 18, 25.
12 Above n1, 1. [Emphasis added]. The problem faced by most of the South East Asian countries includes over-capacity, poor investments, excessive diversification by large business groups, and excessive exposure of debt, ie short-term foreign debts.
13 Ibid.
14 Ibid, 5
15 Shenoy and Koh, above n11, 24.
16 Backman, above n10, 2.

known as '*guanxi*' involved in the operation of the corporate sector. Personal connections exist between the local politicians or big business players who can offer some level of security, other than the legal system. This sort of system provides inadequate governance and is a high barrier for entry by local and foreign investors.[17] The nature and style of business in Malaysia has all the characteristics referred to above. In addition, the Malaysian legal system is not well resourced. However, it is submitted that Malaysia is relatively open and free of corruption as compared to other countries in the Southeast Asian region.[18]

Ownership Concentration, Composition and Operation of Companies and Conglomerates

Ownership structure, composition and operation of companies and conglomerates are the most important factors in determining a good corporate governance system. It is evident that most companies and conglomerates in Malaysia are too big, too unfocussed, too poorly managed and structured, lack transparency, and are devoid of internal checks and accountability.[19]

Ownership Concentration

Concentration of ownership and control in most Malaysian companies and conglomerates tends to be vested by blockholders, which includes the government, families and other institutions.[20] The degree of ownership concentration determines the distribution of power between the officers of the companies and its shareholders. When ownership is concentrated, large shareholders play a significant role in monitoring management of the companies and conglomerates. A fundamental problem of concentrated ownership is the potential expropriation of minority shareholders' rights by the controlling shareholders. Controlling shareholders may act in their own best interests at the expense of minority shareholders and other investors (this problem is further discussed below). Briefly, controlling shareholders may act in their best interests, in the following manner:-

- paying themselves special dividends;
- committing the company into disadvantageous business relationship with other companies they control; and
- taking on excessively risky projects, wherein they share in the upside while the other investors, ie creditors, bear the cost of failure.[21]

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17 Ibid, 7.
18 Ibid, 8.
19 Ibid, 45.
20 Lee Suet Lin Joyce 'Corporate Governance in Asia' (Oct 2001) *Asia Business Law Review* 34, 46.
21 Zhuang, Edwards, Webb and Capulong, above n1, 6.

In 1998, it was found that the largest Malaysian shareholder owned 30.3%, the top five shareholders owned 58.8% and the top 20 owned 80% of total outstanding shares of average public listed companies in the country.[22] Further, evidence showed that most companies and conglomerates in Malaysia are owned and ruled by families, government and other institutional and non-institutional groups.[23]

Ownership Composition

The second key aspect is ownership composition; namely, who are the shareholders and who among the shareholders belong to the controlling group(s). It was found that there were substantial family corporate holdings, whereby ownership is achieved through holding and/or nominee companies.[24] This character of ownership composition is another reason for the distinctive problems in the Malaysian corporate governance system.

According to the ADB Study, the largest shareholder group among the top five shareholders in Malaysia is nominee companies. In 1997, the nominee companies held 45.6% of the total shares of an average non-financial public listed companies held by the top five shareholders. The rest were shared among non-financial companies (5.9%), the government (17.2%), finance companies (5.9%), individuals (4.8%) and foreign investors (1.5%). It was found that most shareholders in Malaysia opted for nominees as a means of not revealing the identities of true holders.[25]

The vast amount of institutional holdings in Malaysia is due in large part to several efforts taken by the government. The government took efforts to implement the New Economic Policy (NEP) or Bumiputra Policy (discussed below) to reallocate corporate shares and ownership of indigenous Malaysians ('*bumiputras*') and at the same time, retract and maintain the ownership of non-indigenous Malaysians (including Chinese, Indians and other mixed races). This resulted in a significant shift in the balance of ownership towards the *bumiputra* population in the Malaysian corporate sector.[26] The high concentration of ownership and composition of shareholdings has, however, made it more difficult to achieve a sound corporate governance system in Malaysia.

Structures of Malaysian Conglomerates

There are two distinctive characteristics in the structures of Malaysian conglomerates, namely cross-shareholdings and the adoption of the pyramid model. These characteristics are classified as problems as they discourage the

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22 Ibid, 22 (Table 1).
23 Backman, above n10, 45.
24 Zhuang, Edwards, Webb and Capulong, above n1, 24.
25 Ibid.
26 Ibid.

corporate sector in Malaysia from having an efficient corporate governance system.

Cross-Shareholdings

It is uncommon to find most conglomerates with one core area of activity, ie there is a high tendency for conglomerates to have many companies that are involved in various businesses within the conglomerate rather than to focus on just one business.[27] Further, most conglomerates have no legal standing as a group, although the individual companies might be registered. Most of its senior executives will have formal positions in one or more of the registered companies and not the conglomerate as a whole. The chairman of the group will have ultimate power and control in the conglomerate despite not having any formal or legally recognised position.[28]

Founding families and other major shareholders of conglomerates do not put great effort into creating and structuring their conglomerates in an orderly manner. Usually, the assets, inventory, and funds of companies in the conglomerates are passed among majority shareholders without due regard to accepted principles of bookkeeping and accounting. As a consequence, poor structure creates minimal transparency within the conglomerate and often most founding shareholders have little idea how their businesses are performing overall, ie cash flow may be mistaken for profits.[29] Therefore, cross-shareholding throws the entire corporate structure of conglomerates into disarray and prevents a good governance system in Malaysia.

Pyramid Model

Majority conglomerates in Malaysia adopt the squat pyramid model in their corporate structure. The pyramid model is a complex and opaque structure, and it is another strategy to perpetuate control in a conglomerate. Here, the private holding company sits at the apex, a second tier holds the most-prized assets that are usually privately held, and a third tier comprises the group's publicly listed companies.[30] According to Thillainathan, the number of layers between the controlling shareholders and the most distant subsidiary is three; nonetheless it

27 Backman, above n10, 46.

28 Ibid, 46-47. The author quotes the example of Robert Kuok (one of the wealthiest businessmen in Asia) who resigned from his last formal position in his many publicly listed companies – chairman of his Hong Kong-based South China Morning Post (Holding) – at the end of 1997. Despite an empire of hundreds of companies, of which at least 14 are listed on stock exchanges around Asia, no one has any doubts about who calls the shots, particularly on the big decisions pertaining to the conglomerate.

29 Ibid, 46-47.

30 Lee Suet Lin Joyce, above n20, 47.

still makes for a significant divergence between control and cash flow rights of the controlling shareholder.[31]

Further, Backman states in his book '*Asian Eclipse – Exposing the Dark Side of Business in Asia*' that 'such a structure makes it easier for the families to implement the maxim: What is profitable is 100% mine; what is less so can be shared with others'. Here, shares are sold to the public, and proceeds are passed up the pyramid through a myriad of internal transactions. As a result, the asset that is less profitable and less desired by the controlling family is passed down the pyramid.[32] In addition, the purpose of the pyramid structure is to draw outside capital into the founding group while at the same time retaining capital within the group.[33]

Therefore, Malaysia and other Southeast Asian countries not only have a serious problem with large concentrated shareholdings, but also have problems with the more widespread practice of pyramiding and cross-shareholdings. These structures give an incentive for founding shareholders to maximise their private benefits of control, and thus create higher probabilities for minority shareholders rights to be expropriated.[34] These structures undermine the efficiency of the corporate sector in Malaysia, and further lead to the deterioration of its corporate governance system.

Chinese Business Networks

The vast Chinese business networks found in Malaysia are a major reason for the high levels of ownership concentration and composition, and the common cross-shareholdings and pyramiding structures found in companies and conglomerates. Malaysia's ethnic Chinese form a well-defined group within the society, ie 29% of the Malaysian population. It is estimated that the Chinese control 60% of the private, corporate and domestic share capital of the nation's economy (prior to the financial crisis).[35] Asia's overseas Chinese are the most commercially successful minority group in the world and in Southeast Asia absolutely dominate majority business and economy in the region.[36]

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31 R Thillainathan, A Review of Corporate Governance in Malaysia, (March 1999) *Banker's Journal,* Kuala Lumpur 23, 44.

32 Backman, above n10, 47.

33 Lee Suet Lin Joyce, above n20, 47.

34 Thillainathan, above n31, 43.

35 Commonwealth of Australia, Department of Foreign Affairs and Trade, East Asia Analytical Unit, *Overseas Chinese Business Networks* (1995), 48.

36 Backman, above n10, 193.

Personal Connections

Generally, connections and relationships, ie '*guanxi*' are critically important when it comes to business amongst this group of people. According to Backman, an integral business value amongst the Chinese is 'know-who is as important as know-how'. Naturally, the Chinese only find it reasonable to trade with people that they know and trust.[37] As a result, most small and medium sized enterprises owned by Chinese are traditionally and typically family-owned. Consequently, most decision-making processes in many Chinese-controlled groups are still preserved among founding patriarch. It is also the case that most capital amongst Chinese businesses comes from retained earnings their businesses, because these businesses often face difficulties raising loans from banks due to inadequate accounting systems.[38]

For instances, the head of the Malaysian MUI Group, Khoo Kay Peng, is known for making most of the Group's decisions and at the same time has no core senior executives to take this role. Further, Hong Leong (M) Group is known to have a good base of senior executives and managers but still major decisions are reserved for the controlling family.[39] Therefore, such beliefs and norms found in Chinese business networks significantly lead to ownership concentration and composition, which contributes to the inefficiency of the corporate governance system in Malaysia.

Keeping it Within the Family

There is a significant distinction between 'insiders' and 'outsiders' amongst the Chinese business networks found in Malaysia and other Southeast Asian countries. Insiders constitute family members (they are automatically awarded unconditional trust) and outsiders constitute non-family members (they must work hard to earn trust). Most Chinese founding members strive to maintain management positions for their family members. In order to do this, many Chinese patriarchs send their children overseas for a Western education, preferably to study Masters of Business Administration (MBA). Upon return the children assume management positions in their companies.[40] In the event that no immediate family members can take over the business, many Chinese patriarchs go searching for the outer reaches of their families to manage their family companies. One example is Robert Kuok, richest Malaysian Chinese businessman, who entrusts the day-to-day operations of his multi-billion-dollar Kerry Group to the husband of a niece.[41] Alternatively, if there are no family members to assume

37 Ibid, 54.
38 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 55.
39 Ibid.
40 Backman, above n10, 55.
41 Ibid.

management positions in the companies, many Chinese companies only recruit people from the same Chinese dialect group as the founding families.[42]
There are specific challenges and problems unique to family controlled companies including, *inter alia*, the following:-

- failure to find capital for growth without diluting the family's equity (total ownership control being a sacrosanct principle for many families);
- an inability to balance optimally the family's need for liquidity and the business's need for cash;
- poor estate planning and the inability of the next generation to pay inheritance or estate duty taxes;
- unwillingness on the part of the older generation to 'let go' of ownership and management power at an appropriate moment;
- an inability to attract and retain competent and motivated family successors;
- unchecked sibling rivalry with no consensus on the chosen successor;
- an inability to attract and retain competent senior non-family managers; and
- unmanaged conflict between the cultures of the family, the board of directors and the business as a whole, and the inability to develop appropriate governance structures that assign optimal roles to each of the governance institutions or bodies.[43]

The factors above lead to the fragility of family businesses and partially explain the bad practices in the Malaysian corporate sector.

New Economic Policy (NEP) / Bumiputra Policy

In 1971, the Malaysian government introduced the New Economic Policy (NEP)/Bumiputra Policy, after communal rioting in 1969 that led to the deaths of 196 Malaysian-Chinese. The Bumiputra Policy was designed to expand the economy and give the *bumiputras*, ie indigenous Malaysian, a bigger share of control in the Malaysian capital markets.[44] The government implemented the Bumiputra Policy because of the unequal distribution of wealth amongst the Malaysian ethnic groups. In order to give the *bumiputras* a greater stake in the economy, this policy provided wide-ranging measures in the corporate sector that were in favour of the *bumiputras*.

> 'The following are the main aspects of the Bumiputra Policy: -
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> - Firms were required to establish plans for employing, training and promoting *bumiputras* at all levels of operations. Such plans were prerequisites for government contracts and licences. B*umiputras*

42 Ibid.

43 P Lawton, 'The Family Business: Its Governance for Sustainability by Fred Neubauer and Alden G. Lank' (1999) 2 *Corporate Governance International* 33, 36.

44 Backman, above n10, 205.

employment quotas varied according to the size of a firm. Larger firms were required to achieve a 40% quota;

- 20% of all loans made by commercial banks were to be made to *bumiputras*;
- *Bumiputras* were given price preferences for all government tenders ranging from 2-10% and additionally, 30% of the contracts were reserved for *bumiputra*;
- Preference was to be given to *bumiputras* in the issue of new licences or permits pertaining to logging, saw milling, timber exports, vehicle import, mining, banking, finance, insurance, transport, and tin and rubber dealing;
- A preferential share allocation scheme was introduced whereby all companies listing on the KLSE must offer at least 30% of their shares to *bumiputras*. This is often achieved by having two floats – a 30% tranche is available only to *bumiputra* applicants, and then 70% tranche is made available to all share applicants including *bumiputras*. The first tranche often sells below the listing price or even the offer price, meaning that those *bumiputras* investors who might acquire shares in the first offer are able to later 'stag' or sell their shares on the open market and realise potentially sizeable capital gains;
- In 1975, the government introduced the Industrial Coordination Act (ICA) requiring every manufacturing firm with shareholders' funds in excess of RM 250,000 or employing more than 25 full-time workers to apply for a manufacturing licence. The Act specified that firms covered must organise in a way which would further the 'national interest', which subsequently was defined by regulations, giving the responsible Minister enormous powers to regulate all aspects of firms' operations. Regulations thus imposed have included: requiring respondent firms to put aside at least 30% of their equity for *bumiputras* interests, requiring non- *bumiputras* firms to employ and train Malaysian citizens to reflect the multiracial composition of the country's population in all grades of appointment up to managerial level; and requiring firms to adopt real measures over a reasonable time to use *bumiputras* distributors to the maximum extent possible, the minimum being 30% of turnover;
- In a further effort to expedite *bumiputras* ownership and control of the economy, the government formed public corporations known as *bumiputras* trust agencies, to buy corporate shares in select companies on behalf of *bumiputras*. For example, Pernas Trading was awarded control of the Malaysia-China trade. Malaysian Chinese traders were then required to pay a commission to Pernas if they wanted to trade with China. This caused much resentment in Malaysia's Chinese community and was ultimately abandoned;
- For a time, the government pursued what has been termed 'ethnic by-pass', in which joint venture between the Bumiputra holding companies and government-linked companies have looked beyond local, Chinese joint venture partners to Japanese partners for heavy investment projects;

- Ethnically based quotas were introduced for local universities. Currently, the official quotas for all local universities stand at 55% for *bumiputras*, 35% for Chinese and 10% for Indians and those of mixed race.'[45]

Upon pursuing the measures in the above policy, the majority of the Malaysian companies and conglomerates and overall businesses have become more governmentally and politically affiliated (discussed below). It was apparent that government-affiliated groups could easily obtain bank loans from government-controlled banks using political influences, and these groups undertook most government projects for which large loans were provided. Further, the Malaysian central bank also waived the single lender limit for government projects in order not to be dependent on foreign funds.[46]

Initially, non-*bumiputra* Malaysians, ie Chinese, Indians and other mixed races disliked the Bumiputra Policy. It was perceived that this policy reflected inequalities in social measures such as restricting the number of places in Malaysia's universities for non-*bumiputra* and forcing all companies (mostly non-*bumiputra* owned) to hire quotas of *bumiputra* employees.[47] In 1985, the Malaysian Chinese group took steps to endorse a declaration calling for the repeal of the ICA, and the abolition of the distinction between *bumiputras* and non-*bumiputras*. Consequently, there are many methods used to get around the said policy, for instance the 'ali-baba' arrangement, which involved the use of *bumiputras* fronts to act on behalf of non-*bumiputras* interests. Alternatively, other non-*bumiputras* business people deliberately chose to keep their interests small or to split their interests into seemingly unconnected units to avoid coming within the purview of the ICA.[48]

However at present, many non-*bumiputras* Malaysian, especially the Chinese were supportive of the Bumiputra Policy and this policy has generated remarkable success, ie achieved a better distribution of economic power in Malaysia.[49] It is found that the employment quotas are no longer a burden because the Bumiputra Policy education measure has now created a class of well-trained *bumiputras* who are useful and productive employees.[50]

Interestingly, the Chinese have to some extent complemented their *guanxi* (ie personal and relationship based) style of business with this policy and concede that sharing business opportunities is a better alternative than having their

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45 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 334-335 (Appendix 8).
46 Zhuang, Edwards, Webb and Capulong, above n1, 55.
47 Backman, above n10, 205.
48 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 54.
49 Ibid, 53.
50 Backman, above n10, 205.

businesses burned down.[51] As a result, there is an increase in mutual interests among the *bumiputras* and the Chinese, and few medium to large companies and conglomerates are now solely Chinese owned. There is now active involvement of *bumiputras* in majority businesses and many Chinese companies and conglomerates now include prominent *bumiputras*, such as an ex-bureaucrat or politician, on their boards.[52] Therefore, it is submitted that the implementation of the Bumiputra Policy has increased the involvement of governmental and political influence into the business environment in Malaysia. Further, the Bumiputra Policy has become complementary to the norm of relationship-based business in Malaysia. This may lead to a distinctive problem of high concentration and composition of ownership, which in turn may lead to weak structures in Malaysian companies and conglomerates.

Governmental and Political Involvement in the Malaysian Corporate Sector

The Malaysian corporate culture, 'knowing who' is as important as 'knowing how'. In recent years, many senior ethnic Chinese business people have urged the Chinese community to build closer links with the *bumiputras*, especially in business joint ventures.[53] Many prominent Chinese entrepreneurs tend to voice their concerns directly to senior United Malays National Organisation (UMNO)[54] figures. For example, Robert Kuok chose early to support the government's Bumiputra Policy and became a founding director of Bank Bumiputera Malaysia, which provided credit to the *bumiputras*.[55] A similar form of encouragement is also given to the Indians and other mixed races in the country.

Many Chinese business groups have not only invested in businesses associated with the Malaysian Chinese Association (MCA), but also invested in UMNO-related interests. For instance, in April 1989, Hong Leong Co (M) Bhd controlled by Quek Leng Chan announced that its publicly listed Hume Industries had won a RM500 million supplies contract from UMNO-owned United Engineers (M) Bhd. Subsequently, Hong Leong announced a rights issue for Hume Industries. Then, Jaguh Mutiara Bhd took up the new shares, giving it a large stake in Hume Industries. The following April, UMNO's main investment arm acquired Jaguh Mutiara. This way the *bumiputra* political and business interests merged with Chinese business interests. [56]

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51 Ibid, 205.
52 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 55.
53 Ibid.
54 Ibid. United Malays National Organisation (UMNO) is the major *Bumiputra* Political Party in Malaysia.
55 Ibid, 56.
56 Ibid.

Further, it is noted that the government's economic policy agenda is to create close co-operation between the government and the private sector, better known as 'Malaysia Inc'. This approach is apparent in the range of government/private sector consultative mechanisms.[57] Here, the government have emphasised the role of the private sector in developing and managing public utilities as part of its privatisation master plan.[58] For example, Malaysia's lottery operation, Sports Toto, was controlled until 1985 by the Ministry of Finance, but was sold to interests associated with entrepreneur Datuk Vincent Tan Chee Yioun. In 1993, the government also awarded a consortium led by Vincent Tan the right to develop a RM6 billion national waste disposal project.[59]

There are significant disadvantages of having strong governmental and political involvement in business environments. This was witnessed in the Multi-Purpose Holdings Bhd (MPHB) saga that happened sometime in the 1980s. The former MCA President Tan Koon Swan set up a non-profit cooperative controlled by the MCA, MPHB and a subsidiary, Koperatif Serbaguna (M) Bhd (KSM), which were the two largest Malaysian cooperatives at that time. Membership of MPHB was open to MCA members only. MPHB initially performed well and the MCA attracted many new members to MPHB during that time. By the mid-1980s there were approximately 3,500 cooperatives of various types of which 34 were deposit-taking and held deposits of almost RM4 billion.[60] The MCAs involvement in business proved to be disastrous. MPHB came close to bankruptcy in the mid 1980s as a result of fraud and mismanagement. After the 1986 elections, the new MCA president, Ling Liong Sik, subsequently removed MPHB's five-seat board of directors and replaced them with non-politicians. Prominent Malaysian businessman Robert Kuok chaired the new board and by mid 1988, Kuok was able to resign after having restored MPHB to profitability.[61]

Hence, it is submitted that majority control and ownership lies in the hands of the government, political parties and families. The nature of business style in Malaysia significantly demonstrates high concentration ownership and composition in its companies and conglomerates. To further compound this distinctive problem in the corporate governance are the traditional norms of the Chinese business networks, the implementation of the Bumiputra Policy and the other economic advancement programs the government has enforced in this country. This characteristic of high ownership concentration and composition and

57 This government/private sector consultative mechanism includes annual dialogue processes between business and the Ministries of Finance and International Trade and Industry, and meetings of the Malaysian Business Council in which key government and private sector interests are represented.

58 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 56.

59 Ibid.

60 Ibid, 57.

61 Ibid.

weak structures of the Malaysian companies and conglomerates were major contributors to the financial crisis of 1997 – 98.

Shareholder Control and Protection

The distinctive characteristics in the mechanisms that exist for shareholder monitoring and control are considered in this part of the article. It should be noted that since the financial crisis, the Malaysian government have taken several steps to reform this area of governance.

Board Composition and Fiduciary Responsibilities

The position in relation to the high ownership concentration and composition, and weak structures of the Malaysian companies and conglomerates leads to a discussion on the role of the board of directors in Malaysia. Boards of directors are expected to formulate corporate policy, approve strategic plans, authorise major transactions, declare dividends, and authorise the sale of additional securities, all of which are crucial activities in the company.[62] The effectiveness of a board of directors in monitoring managers and exercising control on behalf of shareholders depends on a number of factors, which includes:-

- the representation of independent board committees for executive directors on the board of directors;
- independent board committees for remuneration, nomination and auditing; and
- splitting the role of the chief executive officers (CEO) from that of the chairman in the board, in order to improve the protection of shareholders, especially minority shareholders.[63]

As a result of the financial crisis, many Southeast Asian countries including Malaysia, need to minimise conduct involving abuse of power, fraud and mismanagement by the board of directors that could result in significant business losses and deprivation of the members' interest in the companies.[64] Company legislations usually specify the fiduciary responsibilities of directors and impose upon directors a duty to:-

62 Zhuang, Edwards, Webb and Capulong, above n1, 8.
63 Ibid.
64 Anil Joshi a/l Hari Chand 'Corporate Governance and the Re-emergence of a Director's Duty in Negligence in Malaysia', (2000) 27 *Journal of Malaysian and Comparative Law* 147, 149.

- ensure that managers who are hired to run companies and board of directors elected by shareholders to oversee managers, will act in the best interest of the companies and shareholders;
- be loyal (which requires managers and directors to avoid conflicts of interest);
- refrain from self-dealing transactions that compromise the interest of company and its shareholders;
- act in good faith and in a manner which is in the best interest of the company and shareholders.[65]

In order to enhance the standard of corporate governance in Malaysia, the Committee realised that there is a need to create a new generation of directors who are knowledgeable in their duties towards the companies' affairs.[66] Further, there is a need to educate directors to be more proactive in the decision making process of the company, supervising management and directors who will strive to ensure the success of their company within the purview of legal frameworks.[67]

As mentioned earlier, director's duties are stipulated in sections 130 – 132 of the Companies Act 1965 (Malaysia) ('the Companies Act')[68] and reference is also made to the common law position. The present Companies Act does not comprise adequate and/or specify provisions for management to the board of directors in companies. The following are several loopholes in the Companies Act and these sections were considered for reform after the financial crisis:-

- The current section 132 (1) of the Companies Act omits to expressly provide for the duty of care and skill required by the directors;

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65 Zhuang, Edwards, Webb and Capulong, above n1, 8.

66 Phillip T.N. Koh 'Principles, Practise and Prospects of Corporate Governance: The Malaysian Framework' [1998] *ICCLR* (Issue 10) 291, 295.

67 Anil Joshi a/l Hari Chand 'Corporate Governance and the Re-emergence of a Director's Duty in Negligence in Malaysia', (2000) 27 *Journal of Malaysian and Comparative Law* 147, 156.

68 [Emphasis added]. Section 130 prohibits certain persons from managing; section 130A disqualifies a person from being a director if he has been a director of a company which has gone into insolvency; s 131 regulates directors by providing for disclosure of interests, whether directly or indirectly in a contract or proposed contract or holds any office or possess any property which might be in conflict with his duties as directors; s 132 states that a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office; s 132A provides that officers of the company are prohibited to deal with securities; s 132B provides for the prohibition of abuse of information or referred to as 'insider trading' (also provided in s 89 of the *Securities Industry Act 1983*); s 132C requires the approval of a general meeting for disposal by directors of company's undertaking or property; s 132D requires the approval of a general meeting for the issue of shares by directors; ss 132E and 132F requires the approval of a general meeting for substantial property transactions involving connected persons to the company; and s 132G prohibits certain transactions involving shareholders and directors of a company.

- The current Malaysian position is mainly based on the common law position, which emphasises a subjective assessment of care required by directors. There is a need to develop an objective assessment of the standard of care (in part or in whole) in relation to directors' duties;
- The current section 132(1) of the Companies Act is silent on extending this duty of care to officers and merely states the duties of directors;
- There is no legislative provision for making the directors more responsible for the acts carried out by their delegates. The current legislation is silent on whether the directors can in fact delegate their duties and what, if any, are the limits of power to delegate; and
- The Companies Act does not have any statutory provisions for the 'Business Judgement Rule', unlike other Commonwealth countries like Australia and New Zealand.[69]

However, there have been several reforms conducted in this area since 1996 when the Directors Code of Ethics was introduced.[70] Subsequently, in 1998 – 1999, there was an introduction and implementation of the Code on Corporate Governance and Code of Best Practice, which focuses on educating directors as to their roles and responsibilities, monitoring management via the usage of various committees in particular the 'audit committee', extending the role of independent directors and auditors, reinforcing and extending the rights of members to correct and prevent a wrong or an abuse of power by the board of directors.[71] Further, the KLSE listing rules was significantly amended after the financial crisis and now requires every company to have two independent directors who are not related to its officers or do not represent concentrated or family shareholdings. There is a recommendation for companies to form an audit committee as a sub-committee of the board of directors (mentioned above), which should constitute a majority of committee membership being independent of management. This requirement is now mandatory under KLSE listing rules and the appointment of directors should be based on professional expertise, followed closely by the percentage of shareholdings.[72] Further, the Malaysian government supported the formation of the professional associations of directors, and the Malaysian Institute of Directors which runs training courses and is independent of the government has been in operation for several years. Through training courses, professional accreditation and the creation of lists of potential directors, these bodies will promote better understanding of the responsibilities and liabilities of directors, and will focus on the idea of independence.[73]

69 Anil Joshi a/l Hari Chand, above n64, 156-157.
70 Zhuang, Edwards, Webb and Capulong, above n1, 31.
71 Anil Joshi a/l Hari Chand, above n64, 149.
72 Lee Suet Lin Joyce, above n20, 49.
73 Allen J. 'Code Covergence in Asia: Smoke or Fire' (2000) 3 *Corporate Governance International* 23, 26.

Therefore, significant changes and reforms have taken place in Malaysia in this area of governance. However, recommendations and proposals are well and good but at the end of the day there must be proper and on-going enforcement of the reforms. It should be noted that implementing recommendations is a long-term process which needs on-going support to sustain it. Further, the problem of independence of the directors from its founding shareholders must be addressed first, before improving the duties of the board of directors in the companies.

Directors' Remuneration

In order to attract directors of high quality there must be satisfactory compensation provided to them. This factor plays a central role in a sound corporate governance system. The key problem here is one of aligning the interests of managers and shareholders. The exact form of the optimal incentive package depends on the specific details of the agency problem but often involves performance-related pay and award of stock options to managers.[74]

In Malaysia, it is found that the chairman, the CEOs and directors are mostly paid by fixed salary. There are only a few companies where CEOs and directors get a fixed salary plus performance-related pay including stock options. The CEOs and directors propose the remuneration packages for approval by the boards or, alternatively, the remuneration packages are proposed and approved by the board or the executive committees.[75] The Malaysian Code of Corporate Governance recommended that there should be a remuneration committee formed in companies to recommend the remuneration of CEOs and directors in the companies.[76] However, it should be noted that since most companies and conglomerates in Malaysia are either family and/or institutionally owned, there is a tendency for biases and crony capitalism to occur. Thus, this may become another distinctive problem in the Malaysian corporate governance system.

Shareholder Participation and Protection

A sound corporate governance system requires shareholders to actively participate in, and exert influence on corporate strategic decision-making in companies. This depends on whether shareholders' legal rights are adequately protected, which is another issue to consider in the Malaysian corporate governance system. Basic shareholder rights should entitle shareholders to access regular and reliable information, call emergency shareholder meetings, make proposals at shareholder meetings, and permit for full pre-emptive rights on new stock issues unless voted otherwise. Further, companies have to disclose specified information to

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74 Zhuang, Edwards, Webb and Capulong, above n1, 8-9.
75 Ibid, 32.
76 Lee Suet Lin Joyce, above n20, 49.

shareholders, such as connected interests, company affiliations, affiliated lenders or guarantees, and other relevant interests of the company.[77]

The Companies Act protects Malaysian shareholders by:-

- stipulating regulations governing the duties of company directors;
- requiring AGM approvals for the acquisition or disposal by directors of assets of substantial value, and for the issue of shares;
- prohibiting loans to directors or director-related parties, unless they are subsidiaries;
- disclosing and requiring shareholders' approval on substantial transactions in any non-cash assets involving directors or persons connected with directors; and
- disclosing substantial shareholdings to the company and KLSE.

There are four main causes of legal action 'available to' shareholders *inter alia* as follows:-

- Member's personal action whether based on express shareholder's contract in the form of incorporated joint venture forms or where a company is listed on a stock exchange, on the basis of implied term in the contract between the shareholder and the company that the company will comply with the listing rules of the Stock Exchange;7[78]
- Member's derivative action, being an action brought by a member or members based on a cause of action vested in the company alone rather than a cause of action based on plaintiff-shareholder personally;
- Member's application for an order of winding-up (section 218 of the Companies Act);
- Member's statutory remedy for oppressive or unfair conduct of company's affairs (section 181 and section 218 (f)(i) Companies Act).[79]

The Securities Industry Act 1983 also establishes several forms for protection to shareholders, which provide more effective supervision and control of the securities industry by regulating the operations of dealers, and prohibiting artificial trading and market rigging. Thus, in Malaysia, the rights and protection of shareholders appears to be both comprehensive and well defined.[80] The Malaysian government has also looked into setting up a 'Minority Shareholder Watchdog Group', which is driven by the Employees Provident Fund, a statutory

77 Zhuang, Edwards, Webb and Capulong, above 1, 9.

78 *Zytan Nominees Pte Ltd v Laverton Gold NL* (1988) 12 *ACLR* 524.

79 Phillip T.N. Koh 'Principles, Practise and Prospects of Corporate Governance: The Malaysian Framework' [1998] *ICCLR* (Issue 10) 291, at page 297.

80 Zhuang, Edwards, Webb and Capulong, above n1, 36 – 37.

body with a board appointed by the minister of finance, and enlist other domestic institutional investors to join the said Watchdog Group.[81]

However, the ADB Study found that the number of shareholders who are acknowledged at AGMs is low and there are few rejections of proposals put forward to the management or the board of directors at the AGMs. In the case of locally controlled companies, the control exercised by the majority shareholders is usually in relation to the excess of their cash-flow rights, whereas foreign owned firms are seen to pay more attention to shareholder rights and to pay a higher level of dividends.[82]

Further, it is found that minority shareholders are perceived as 'outsiders', particularly in most Chinese companies and conglomerates, where they are potentially categorised as 'ultimate strangers'.[83] Majority shareholders (of companies listed on the stock exchange) treat minority shareholders unfairly in three main ways, namely:-

a) controlling shareholders have far too many rights issues;
b) controlling shareholders buy assets from other associated controlling shareholders even though it is prohibited; and
c) controlling shareholders trade with related companies on an unfair basis.

Further in practice, the legal costs of funding a minority shareholder action and the complexity of both substantive and procedural requirements have proved to be almost overwhelming for the minority shareholders.[84] Usually, controlling shareholders are often not interested in achieving a fair rate of return on shareholder's funds. Controlling shareholders ensure that they do quite well, but their returns may be at the expense of their minority shareholders.[85]

It is noted that the issue of enforcement of shareholders' rights arises only in the context of the minority shareholders; the majority shareholders can call a general meeting to dismiss directors, but with the concentration of share-ownership in many companies, majority shareholders are most often also directors. Reference is made to the rule in *Foss v Harbottle*[86] which laid down two famous principles; (1) that the corporation is the 'proper plaintiff' for wrongs done to the corporation, and (2) the non-interference of courts in relation to conduct by directors which is capable of being ratified in general meeting. The *Foss v Harbottle* rule is definitively inhibitive of shareholders' ability to utilise legal remedies. This rule only provides exception in relation to acts of directors which are found to be; (1)

81 Allen, above n73, 34.
82 Zhuang, Edwards, Webb and Capulong, above n1, 36 – 37.
83 Backman, above n10, 82.
84 Koh, above n79, 297.
85 Backman, above n10, 83.
86 (1843) 2 Hare 461.

ultra vires, illegal or criminal; (2) fraud against the minority; and (3) invasion of personal rights.[87]

The efficiency of protection provided to shareholders is linked with the protection provided to local and foreign investors that are interested in becoming part of a Malaysian company and conglomerate. After the financial crisis, Malaysian companies came under the close scrutiny of local and foreign investors, and the lack of good corporate governance contributed to the loss of investors' confidence.[88] Investors are aware of the potential and actual expropriation of their rights by controlling shareholders. According to Walker G and Allen J, it is evident that expropriation of minority shareholders is common in Southeast Asian countries, including Malaysia, and that there is a need for efficient legal rules and enforcement.[89]

The authors found significant consequences of poor investor protection, which is also apparent in Malaysia. First, there is evidence that there is poor investor protection when there is high concentrated ownership and crony capitalism present in the corporate sector. Thus, there are attempts by investors to minimise their risk by keeping their claims short term in order to exit at the first sign of trouble.[90] Hence, the level of shareholder protection is Malaysia is well defined and comprehensive. Despite this fact, there are several issues in this area of governance which need to be considered to further enhance the efficiency of governance in this area.

Transparency and Disclosure

The quality of transparency and disclosure depends crucially on accounting and auditing standards, and the financial reporting system in the corporate sector. Auditing is crucial to commerce and is an essential component of the framework for any modern economy.[91] Without the reports of independent auditors, the public has no way of verifying companies' claims of their financial health, few investors would want to buy shares of the company and banks would not want to lend money to companies.[92] The adoption of internationally acceptable accounting standards will certainly improve the quality of transparency in Malaysia.

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87 Koh, above n79, 297.

88 Jeyapalan Kasipillai, 'Insights on Corporate Governance in Malaysia', An International Perspective on Corporate Boards and Governance edited by N Balasubramaniam, (1999) *The Malaysian Insurance Institute*, 83.

89 G Walker and J Allen, 'Corporate Governance in Southeast Asia: Evidence and Justifications' (Oct 2001) 19 (7) Company and Securities Law Journal 437, 454 who referred to the working paper of La Porta R., Lopez-de-Silanes F., Shleifer A., and Vishny R. *'Investor Protection and Corporate Governance'* (2000).

90 Walker and Allen, above n89, 454-456.

91 Zhuang, Edwards, Webb and Capulong, above n1, 10.

92 Backman, above n10, 22.

Auditing is a sensitive matter and is a process that is not accepted well in most Southeast Asian countries including Malaysia. According to Backman, 'Asia's corporate world upholds secrecy and dislike transparency, in particular where management is patriarchal and bosses perceive that they can do no wrong'. Therefore, it is an uncomfortable process to have the company's books assessed by outsiders. [93]

Well-established accounting firms such as Arthur Andersen, Deloitte Touche Tohmatsu, Ernst & Young, KPMG Peat Marwick, and PricewaterhouseCoopers, have all set up in Malaysia. It is found that Malaysia scores relatively high, even by international standards, for the general quality of its auditing and financial reporting. In the 1980s Malaysia adopted standards that are similar to those issued by the International Accounting Standards Committee (ISAC). The approved accounting principles in the Malaysian Accounting Standards also covers issues not dealt with in the ISAC, and reflect particular features of the Malaysian business-environment. The Research Institute of Investment Analysis in Malaysia was established in 1985 by the KLSE to enhance the level of investment analysis, research and professionalism in the Malaysian securities industry.[94] Further, the setting up of the 'Minority Shareholder Watchdog Group' by the Employee Provident Fund is intended to encourage shareholder activism in Malaysia, which would be an essential component of a disclosure based regulatory regime.[95]

However, one great problem for auditors in Southeast Asia, including Malaysia, is the tendency for many locally listed firms to shop around for an auditor that is most likely to do their bidding, and replacing auditors is much more common in Asia. If companies do not get the result they want from their auditors, they may threaten to take their business elsewhere. Hence, auditors face a great deal of pressure to be sympathetic towards the companies they audit.[96]

Therefore, the independence of auditing is the key to ensuring that information disseminated to the shareholders and investors is reliable and credible. This would result in good financial reporting systems.[97] Due to the high level of ownership concentration and composition, cross-shareholdings, pyramiding structure and crony capitalism, the question of high quality in transparency and disclosure may be doubtful.

93 Ibid, 23.
94 Zhuang, Edwards, Webb and Capulong, above n1, 40.
95 Shenoy and Koh, above n11, 25.
96 Backman, above n10, 24.
97 Zhuang, Edwards, Webb and Capulong, above n1, 10.

Creditor Monitoring, Disciplining and Protection

Creditors including banks and non-bank financial institutions in general have limited involvement in companies' management and decision-making process, and certainly play a weak role in corporate governance. This is because:-

- creditors are poorly governed due to the weak internal control and inadequate regulation and supervision;
- the relationship-based business practice and potential crony capitalism limits competition within the banking system.

In some cases, creditors, banks, and financial and non-financial institutions form part of conglomerates in Malaysia. This situation distorts lenders' incentives to discipline creditors, and further weakens creditors' incentives to monitor, discipline and protect.[98] At this point, it is important to consider the role of banks, financial institutions and conglomerates in Malaysia.

The Role of Banks, Financial Institutions and Conglomerates

A strong banking system is essential for the Malaysian economy and corporate sector. Essentially, banks must be prudently managed, carefully regulated (not stifled), transparent in their operations and balance sheets, and most importantly, independent of non-financial sector interests.[99] Banks in Malaysia play a dominant role in lending. Malaysian banks do not play a role in governance (with respect to the appointment of managers or directors or the choice of investment) because they do not control or vote significant blocks of shares or sit on the board of directors in the banks.[100]

Malaysian banks are relatively independent of non-financial interest. This is because of the implementation of tight central banking rules. Consequently, most principal shareholders of the country's banks have interests only in the banking sector. However, there are several major exceptions in the banking system. Since some banks form part of some conglomerates, majority shareholders of the banks are usually families and/or institutions, and each member often has his or her own business interest in it. Backman states that 'most banks really are: piggy banks used by their controlling shareholders for private purposes, while collecting funds from members of the public'.[101]

For instance, Hong Leong Bank controlled by Quek Leng Chan (formerly owned by Khoo Kay Peng when it was known as MUI Bank). This bank is found in Quek's

98 Ibid, 41.
99 Backman, above n10, 59 – 60.
100 Thillainathan, above n31, 39.
101 Backman, above n10, 60.

conglomerate amongst other big companies, such as Hume Industries, Nanyang Press, Hong Leong Properties, and Hong Leong Industries. The other exception is Multi-Purpose Bank, which is part of the Multi-Purpose Group, which has enormous and diversified interests that stretch across gaming, property development, shipping, and hotels.[102] Further, there are some Chinese-owned banks with a dialect-based clientele, ie the Hock Hua Bank. This bank exclusively provides for the Fuzhou Hokkien community. Here, non-Fuzhou are able to bank with Hock Hua Bank, but it is suspected that the Fuzhou get better terms in relation to borrowing.[103] Therefore, it is submitted that borrowing from conglomerate's bank is the best defence against poorly enforced business laws. It also keeps the interest rate margin in-house and provides easy credit to their affiliated groups.[104]

At present, there are few Malaysian commercial banks that are part of conglomerates. In 1991, a significant deregulation measure was introduced in the Malaysian banking sector which involved the liberalisation of the base lending rate, whereby rates are allowed to be determined on the basis of each leading institution's own cost of funds. In 1994, a two-tier regulatory system for commercial banks was introduced. This allowed well-managed banking institutions with strong financial standing to conduct certain operations under a more liberal regulatory environment. This liberalisation was aimed at reducing the cost of compliance and increasing the efficiency of cross-border transactions of residents. In 1995, this framework was further liberalised, when each lending institution was free to quote its own base lending rates subject to an industry ceiling rate determined in relation to the 3 month inter-bank weighted averaged rate. [105] According to Chin Kok Fay and Jomo K.S., the financial liberalisations and reforms were premature and contributed to the crisis of 1997/98. The authors claim that the liberalisation of the domestic financial system, ie eliminating interest rates control and credit allocation and reliance on market forces, before putting in place a system of strong and effective regulation and supervision of the financial institutions, led to hazards and significant problems in the banking and financial sectors in Malaysia.[106]

Previously, a significant characteristic of Chinese business networks was the reliance on retained earnings or occasional illegal moneylenders operations within its networks. In Penang, many traditional Chinese business practices still raise capital through the *'tontine'* system, whereby a group of twenty Chinese businesses in one area might contribute RM5, 000 each to a pool of funds, in which one member each month either wins or buys the right to access the funds at a

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102 Ibid, 59 – 60.

103 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 58.

104 Backman, above n10, 49.

105 Zhuang, Edwards, Webb and Capulong, above n1, 42.

106 Chin Kok Fay and Jomo K.S. 'Financial Liberalisation and System Vulnerability', *Malaysian Eclipse: Economic Crisis and Recovery* edited by Jomo K.S. (2001), 130.

nominal interest rate.[107] Credit cooperatives once played an important role in these networks. These are non- profit, deposit-taking institutions usually managed by a clan or some Chinese associations. For example, clan-and-dialect-based cooperatives includes the Koperasi Sepadu Bhd, which was started by the Eurasian and Hakka communities, and Koperasi Jasa Rakyat Bhd (Kajasa) which was formed by the youth movement of the Federation of Hokkien Associations of Malaysia.[108] In 1986, the government froze twenty-four deposit-taking cooperatives (DTCs) where approximately 588,000 Chinese Malaysians had deposited a total of RM1.4 billion collectively. Subsequently, investigations found that apart from suffering from mismanagement and fraud, many of the cooperatives did not act as non-profit managers of deposits but acted as profit seekers and share speculators. Consequently, the reputation of these cooperatives as some form of financial institutions was damaged and has declined in its importance.[109]

Therefore, having a good banking and financial system is very crucial to the Malaysian corporate governance system. Although, the relevant regulatory authorities have taken active steps to improve the banking and financial system, there is still a small group of companies and/or conglomerates that raise capital and obtain loans in other ways. There is still a need to address the problem in relation to this issue in the Malaysian corporate governance system.

The Effectiveness of Insolvency and Restructuring Laws

The ADB Study indicates that the insolvency legislation is old and no longer suitable for the new business environment, and also found that there are many omissions and loopholes in the legislation. In practice, the insolvency procedures are in general slow, inefficient and costly, and this is partly due to the inefficient judicial system. Here, the inefficient insolvency procedures put creditors and members of the company in a disadvantageous position, and also discourage the commencement of legal action against companies which are in default. Further, there are some companies, which are sometimes interconnected through ownership or other business relationships with their creditors. This is another factor that creates further obstacles for creditors who wish to take legal action against companies that are in default. Thus, it is arguable that the insolvency legislation and procedures in Malaysia are ineffective in both protecting creditors and in disciplining borrowers.[110]

In Malaysia, the insolvency procedure is modelled from English law with a mix of creditor-oriented formal and informal procedures for bringing debtors and creditors together to restructure loans. However, before the financial crisis, there

107 Department of Foreign Affairs and Trade, East Asia Analytical Unit, above n35, 57.
108 Ibid.
109 Ibid, 58.
110 Ibid, 44.

was no unified approach in this area.[111] The insolvency remedy is provided in section 218(1)(i) of the Companies Act, which gives a wide discretion to the court and may be exercisable in favour of the petitioner where:-

- the substratum of the company is destroyed;
- when the company is fraudulent from its time of incorporation;
- when the company is no longer profitable;
- where the company is a quasi-partnership and the members are unable to cooperate; and
- where there is fraud, misconduct or oppression in management.[112]

It should be noted that this remedy is not available when there are mere differences between directors, ie this does not amount to a ground for winding up.[113] As mentioned earlier, the entire insolvency procedure is meticulous and difficult and is in the end, dependent on, the wide discretion of the courts. Most cases never reach the court or are never settled due to the difficult and substantive nature of an insolvency action.[114] Further, it is noted that insolvency proceedings often take years to complete because they are so complicated. There is a tendency for creditors to renegotiate outside the formal insolvency procedures, especially when the legal and judicial system is less reliable, and the insolvency laws are less complete.[115]

Next, the restructuring regime appears to be slow and ineffective in Malaysia. Part VII (ss 176 – 181) of the Companies Act deals with the rehabilitation and restructuring of companies. Section 176 of the Companies Act provides for the preservation of the company as an ongoing concern, while enabling creditors to recover monies under compromise and reorganisation arrangements that have legal sanction from the courts. However, there are no well-defined judicial management procedures provisions for managing schemes of compromise and reconstruction. Further, the process is cumbersome and the courts have limited experience in supervising reorganisation schemes.[116]

However, since the financial crisis, Pengurusan Danaharta Nasional Berhad ('Danaharta')[117] was established in 1998 to acquire non-performing loans from

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111 Ibid, 44-45.

112 Koh, above n79, 298.

113 Ibid. The author refers to the cases of *Re: Xing Ji Food Products (M) Sdn Bhd* (1988) *Malaysian and Singapore Company Law Cases* 90 and *Ng Eng Hian v Ng Kee Wai and Orthers* (1950-1985) *Malaysian and Singapore Company Law Cases* 7.

114 Ibid.

115 Thillainathan, above n31, 41.

116 Ibid.

117 Danaharta Homepage, 'Background To The Pengurusan Danaharta Nasional Berhad Act 1998 (Danaharta Act)', <http://www.danaharta.com.my/default.html> cited at 2/9/03. Danaharta was established under the Danaharta Act in 1998 as a limited

banks and assets from distressed companies to minimise the problem of a credit crunch as well as to facilitate an orderly payment or write-down of debts. Here, the legal process followed by Danaharta aims to compensate for the absence of a well-defined scheme of Judicial Management of corporate restructuring under the Companies Act. The goal is to expedite and shorten the legal procedures and to bring professional expertise in designing and implementing reorganisation plans in companies.[118]

In Malaysia, creditors in general do not have influences on companies' management and decision-making process.[119] Here again, the Malaysian government and relevant authorities have taken positive steps to improve the protection provided to creditors. However, good enforcement of the law and recommendations considered in this area of governance by the administrative and judicial system, will further enhance the quality of the insolvency and restructuring laws and procedures.

The Media Business in Malaysia

Finally, this paper takes into consideration the media business in Malaysia and its effect on the corporate governance system. It is submitted that an efficient business environment requires a sound media business, enforced business laws and independence.[120] The local media in Southeast Asia including Malaysia has a high level of censorship, pay low wages to journalists and lack of independence. There is limited distribution of foreign newspapers and books.[121] Most media businesses are affiliated with other non-media interests, ie media organisations do not just concentrate on media. Thus, the significant problem here is that newspapers and other forms of publications are unlikely to expose accurate, precise and controversial aspects of affiliated companies with the media.[122]

For instance, the Malaysian Resources Group, one of the biggest conglomerates in Malaysia, has interests in infrastructure development, engineering, power

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liability corporation owned by the government. The Danaharta Act sets out Danaharta's main operation to act as the national asset management company and to acquire, manage, finance and dispose of assets and liabilities of companies with non-performing loans (NPLs). The Danaharta Act confers two special powers: (1) the ability to buy the companies' assets through statutory vesting from selling banks. Here, Danaharta is able to acquire assets at the priority as the selling banks in order to attain certainty of title and maximise value; (2) the ability to appoint Special Administrators to manage the affairs of distressed companies.

118 Ibid, 42.

119 Zhuang, Edwards, Webb and Capulong, above n1, 42.

120 Backman, above n10, 33.

121 Ibid, 34.

122 Ibid, 36.

generation, and property. It also has a media arm through which it controls Malaysia's leading English-language newspapers, the News Straits Times, as well as the Business Times and the Malay Mail. It also controls TV3, a national television channel. Clearly, there will be potential conflict of interests between the media and non-media arms of the conglomerate in relation to independent reporting.[123] Another big conglomerate is the Hong Leong group controlled by Quek Leng Chan, which has enormous interests in banking finance, hotels, and property. It also controls the Nanyang Press Group, which publishes two of the larger Chinese-language newspapers in Malaysia, Nanyang Siang Pau and China Press, as well as at least twelve Chinese-language magazines, and also a book printer and Channel KTV, a regional cable and satellite television company.[124] Here again, there will be potential conflict of interests amongst this conglomerate, and this could undermine the issue of its media independence.

In Malaysia, the constraint of the local media is simply another inadequacy in its corporate governance system. The government has the responsibility of ensuring that disclosure of information in the media is accurate in order to give the public informed knowledge of the corporate sector in Malaysia. There has not been much reformation to date in this area of governance.

Conclusion

This article examines several distinctive problems of corporate governance in Malaysia. The first is the high level of ownership concentration and composition, and weak corporate structure, ie cross shareholdings and pyramiding, in Malaysian companies and conglomerates. For good corporate governance practice it is crucial that ownership be diverse and well structured. The distinctive characteristics of the Chinese business networks, the implementation of the Bumiputra Policy and significant governmental and political involvement in the corporate sector may be obstacles to good corporate governance practice in Malaysia. This problem has a great influence on the other distinctive problems involving shareholders, creditors and media business in Malaysia. Ownership concentration, composition and structure of the companies and conglomerates, determines the unique nature of managing, operating and running the business and if there are deficiencies in this area, the entire corporate sector and governance system will be affected.

Second, leading from the above problem, there is inadequate shareholders' control and protection provided in the Malaysian corporate sector. The composition of the board of directors is undermined by the high level of ownership concentration, which leads to potential expropriation towards minority shareholders. Further,

123 Ibid.
124 Ibid.

directors' duties and responsibilities are not clearly and fully set out in the Companies Act and common law. Although there have been significant reforms in this area, it will take a long time before any effective results can be seen, as it is a long-term process and requires tremendous on going support to sustain it. In relation to directors' remuneration, there are few companies that pay directors and CEOs performance-related salaries. Here, due to the problem of high concentration of ownership, there is a tendency for biases and crony capitalism to occur. Another problem is the limited participation and legal protection provided to minority shareholders. Although there have been several active steps for reform have been taken, there is a need for better legislative protection. Finally, the auditing system in Malaysia is well governed by local and international standards. However, the quality of disclosure and transparency is questionable when high concentrated companies and conglomerates shop around for auditors who are willing to report desirable results wanted by their owners. This undermines the reliability and creditability of financial reporting systems in Malaysia.

Third, there is a problem in relation to creditor monitoring, disciplining and protection in Malaysia. It is submitted that creditors are poorly governed due to weak internal control and inadequate regulations and supervision. Also, the relationship-based business practice in these high concentrated companies and conglomerates limits the competition within the banking system in Malaysia. The banking and financial system is relatively independent of non-financial interests, however, there are several exceptions. There are some banks and financial institutions that form part of conglomerates, which leads to inefficient banking and financial systems. Further, the reforms and developments in the banking and financial system, ie liberalisation of the domestic financial system, is premature as it was put in place before the banking and financial system could be effectively governed by strong regulation and supervision. Previously, the traditional method of raising capital in the Chinese business networks and the deposit taking cooperatives has also undermined the banking and financial system in the country. This is not an apparent problem at present, but there are still a small number of Chinese businesses that adopt this style of business.

Finally, this article discussed the non-independence of the media business in Malaysia. Most media are part of conglomerates that have numerous interests in other areas. The corporate and financial information disseminated in the media is likely to be inaccurate, unreliable and not precise. The affiliation of media business with non-media business also creates possible conflicts of interests in the conglomerates. Thus, one requirement of a sound corporate governance system is a sound media business, and this requirement is not met.

In order to develop and create a good and efficient corporate governance system in Malaysia, it is essential to address or remedy the four main issues highlighted above. Several active and positive reforms have taken place in the country, and the corporate governance system is better than those in some other Southeast

Asian countries. However, the distinctive problems discussed in this article should be addressed, as a step to enhance the corporate governance system in Malaysia.

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