

MASTER OF BUSINESS ADMINISTRATION

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**CORPORATE GOVERNANCE IN MALAYSIAN PUBLIC LISTED
COMPANIES FROM THE ETHICAL AND LEGAL
PERSPECTIVES
(A CASE STUDY OF A MALAYSIAN COMPANY)**

BY

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**A RESEARCH PROJECT PAPER SUBMITTED IN PARTIAL
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ABSTRACT

This study examines the level of corporate governance practiced in public listed companies in the Kuala Lumpur Stock Exchange(KLSE) from both the ethical and legal perspectives. The study focuses firstly on the external controls with regard to the adequacy of laws to protect the shareholders and secondly, on the internal control, mainly on the role of the board of directors with special emphasis on ethical and legal aspects when making business decisions. In order to demonstrate the importance of the director and the disastrous consequences of failure if they neglect their duties, the present study was conducted on AB Berhad, a public company listed on the main board of the KLSE in the construction sector.

In terms of external controls, the legal framework for corporate governance is fairly sound as there are generally adequate laws and regulations which govern the affairs and activities of the companies. To ensure its effectiveness they are continuously reviewed and amended. However, as far as enforcement is concerned, it should be more effective and the relevant agencies should play an active role to ensure all the wrongdoers are punished and made an example of to show other companies that no one is above the law.

As for the internal control, the focus is on the director's role. The analysis shows that the human factor is very important and from the case study, it can be seen that the board of directors of AB Berhad did not adopt the ethical aspects of corporate governance found in core values namely accountability, responsibility, transparency, honesty and equitable treatment while making business decisions for the company. As a result of the poor corporate governance practiced and the failure to adhere to the laws and regulations governing companies, AB Berhad has turned from

a profit making company with good asset backing to a debt-ridden company running at a loss.

APPROVAL PAGE

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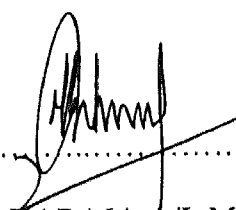
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19 June 2002

DECLARATION

I hereby declare that this project paper is the result of my own investigation, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

Date: 19 June 2002

Signature.....

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CHAPTER 1

INTRODUCTION

1.1 Background of the Study

A company is a legal entity that is separate from its members or shareholders, its directors and from its employees. Companies are important because they are the engines of economic growth of a nation and to a certain extent in the case of Malaysia its economy depends on the drive and efficiency of its companies. Apart from sound macroeconomic fundamentals and attractive fiscal incentives, sound corporate governance and effective control systems must in be place for a country to attract investment.

Even though there are many factors that contribute to the competitiveness of a firm, a market or an economy, such as superior resources, better technology and so on, good governance or management is a precondition for competitiveness that underlies all these other factors.

Both local and foreign investment are important for Malaysia as a developing country because they promote the country's economy and are a vital element in the country's continued development as their support can play an increasing role in realizing sustained growth and prosperity for the nation

The private sector complements the public sector in providing employment as the public sector can only provide limited job opportunities to its citizens. Apart from

providing employment, when a company makes a profit, the government too gets its cut from the corporation tax and, in return, the government can utilize this revenue for development and infrastructure projects for the well-being of the people. A corporation should always realize that to be competitive and to stay ahead of its competitors it needs to have an advantage over its competitors and only by this can it generate higher revenue at a lower cost.

The company's board of directors and its management should always be aware that to maintain the existing shareholders from selling off their shares and to attract potential investors to invest in their company, they must ensure that the financial performance of the company improves from one year to another as this will ensure the existing investors get a steady return in the form of dividends and appreciation in their shares. High income can only be generated when the corporations keep their operating costs low and maintain high productivity and, most importantly, when the board of directors who are entrusted to run and operate the business act honestly and in good faith, with responsibility and by exercising skills and care whilst adhering to the laws, regulations, code of conduct and best practices.

The board of directors should at all times ensure that the interests of shareholders and other stakeholders such as creditors, employees, suppliers are paramount and well protected by practicing good corporate governance in the company with which they are entrusted. The directors with a good corporate governance practices in a company

should be able to balance wealth creation, on the one hand, and protect the interests of shareholders and the other stakeholders, on the other hand.¹

The board of directors, appointed by the shareholders with the responsibility of enhancing the shareholders' value and protecting other stakeholders' interests in the company, are given the task of managing the multi-million dollar capital of a company. The directors, in return, must perform their duties with full commitment and should not at any time allow personal interest to override the interest of the company's shareholders and other stakeholders.

Since the directors of public listed companies are subject to the high expectations of their shareholders, they should only assume the post if they possess the required skills, talents, and expertise and not merely because they are related to the chairman, chief executive officer or majority shareholder.

Company directors should realize that if they do not perform their jobs within the proper system of corporate governance, they are liable to be sued by the shareholders and others because they are the guardians of the shareholders' interests.

The directors must live up to the expectations of the shareholders and display the highest professionalism when conducting their business by ensuring that there is proper transparency and disclosure of all dealings or transactions above a certain threshold involving the board.

¹ Wong, Wai, Corporate Governance: The debate continues, Chartered Secretary, London, 2000, pp. 20.

1.2 Statement of the Problem

In Malaysia, all companies must be incorporated under the Companies Act 1965. The responsibilities of company directors towards the shareholders and other stakeholders are clearly stipulated in the following:

a) Legislation

- i. The Companies Act 1965 and Regulations and Code On Take-Overs provide a framework to safeguard the interest of shareholders and other stakeholders
- ii. The Securities Commission Act 1993 provides the framework to regulate and develop the capital market
- iii. The Securities Industry Act 1983 and the Securities Industry Regulation provide a framework to regulate the issues of licenses and renewals to dealers

b) Self regulations

- i. Malaysian Code on Take-Overs and Mergers 1987
- ii. Kuala Lumpur Listing Rules
- iii. Articles of Association of a company

c) Common law

Common law duty to act with reasonable care and skills failing which they may be liable to civil and criminal suits.

In Malaysia, public listed companies listed on the Kuala Lumpur Stock Exchange such as Malaysia Airlines System, Renong, United Engineers Malaysia failed to overcome the Asian financial crisis and need to be restructured. Although the failure of these companies was partly due to the Asian financial crisis, it cannot be denied that other factors such as poor risk management and rather lax corporate governance practiced in these companies played a part in worsening the situation.²

The problems identified in Malaysian listed companies as being reasons for their poor performance and failures are notably:³

a) Poor disclosure practices

They include untimely release of financial and other information, misleading announcements in newspapers, inability to call for a general meeting within the prescribed period and non-disclosure or late disclosure of substantial shareholdings by the directors. There were also cases in which some public listed companies repeatedly breached listing requirements.

b) Corporate abuses

They include related party transactions involving substantial acquisitions or disposal of property which is an offence under section 132C of the Companies Act 1965; substantial property transactions, an offence under section 132E of the Companies Act 1965; the acquisition of shares from a director, or

² Raj, Charles, Looking out for Investors, Malaysian Business, Kuala Lumpur, 2000, pp. 28.

³ Idrus, Harun, ROC Corporate Directors' Training Programme, K.Lumpur, 2000, pp. 12 – 13.

substantial shareholder of an acquiring company which is an offence under section 132G of the Companies Act 1965.

c) Disregard for the laws

Listed companies, which are accountable to shareholders and which are expected to practice the highest level of corporate governance, can be so lackadaisical in conducting their affairs. The blatant disregard for the law seems to stem from the fact that the penalty is no more than a fine or a reprimand or, at worst, both⁴.

d) Unawareness of shareholders' rights

Most of the shareholders are not aware of or interested in knowing the rights vested in them and the course of action that can be taken against the company and their directors. The shareholders in Malaysia seem to be interested in investing in shares based on market rumors rather than looking into the fundamentals and financial performance of a company. The reason for this is that they are interested in mainly short-term capital gain and when they purchase the shares they anticipate the share price will increase in a short-term period and, as such, they can be considered as mere speculators and not real long-term investors.

The rights of shareholders in Malaysia are clearly stipulated in the Companies Act 1965. They include:

⁴Raj, Charles. When Fine is Not a Fine, *Malaysian Business*, Kuala Lumpur, Oct 16, 2000, pp. 23.

- a) Court injunction under section 132C and 132E of the Companies Act 1965,
- b) Order under section 181 of the Companies Act 1965 against oppressive action
- c) Requesting the Minister for an inspector to be appointed for the purpose of investigation under section 192 of the Companies Act 1965
- d) Winding up a company under section 218 of the Companies Act 1965
- e) Taking a derivative action under the rule in Foss v Harbottle

In the case of Malaysian public listed companies on the Kuala Lumpur Stock Exchange, a company can be easily identified as a failure or one in difficulties when the securities of the company are reclassified from its original sector to the “Practice Note 4 Condition” sector. There are 91 public listed companies that were identified as failures in 2001.⁵ Practice Note 4 companies are those that have failed to meet the minimum requirements set by the Kuala Lumpur Stock exchange, which include deficits in their shareholders funds and the appointment of Special administrators over their assets or themselves.

Firms are considered a failure when they apply to the court or relevant authorities for restructuring or reorganization schemes based on a scheme of arrangements pursuant to section 176 of the Malaysian Companies Act 1965.⁶

⁵Shanmugam, M and Sze, Facing the Axe, Malaysian Business, Kuala Lumpur, July 1, 2000, pp. 22.

⁶Muhammad Sori, Zulkarnian. Mohamad, Shamsheer. Abdul Hamid, Mohamad Ali. Mohd Nassir, Annular. Determinants of Corporate Success and Failure: The Malaysian Case, Akauntan Nasional, Kuala Lumpur, March 2002, pp. 23.

1.3 Objectives of the Study

The objectives of the study are to find out, firstly whether the external controls in Malaysia, the existing laws, regulations and rules that has been enacted to govern the companies, are sufficient to protect the interests of the shareholders and stakeholders of a company. Secondly, the study aims to investigate the internal controls, mainly the role of directors and their abuse of their posts. We will do this both in a case analysis of how the directors in AB Berhad failed in their fiduciary duties and how they could and should have prevented these unethical and even illegal abuses of the management.

1.4. Significance of the Study

The study will identify the importance of corporate governance in public listed companies which are financed by the public and demonstrate how a corporation which stresses good corporate governance can enhance its shareholders' value, goodwill and encourage confidence to invest in the company.

The study will also examine the findings of a case study on AB Berhad,(company's name not disclosed due to confidentiality), a company that was listed on the First Board of the Kuala Lumpur Stock Exchange under the construction sector, which failed because of poor corporate governance and unethical business practices. As a result of the failure, Pengurusan Danaharta Nasional Berhad (Danaharta) acquired various loans provided to the company and appointed special administrators to carry out an assessment of the viability of the operations and business of the company. The outcome of this study was useful and would serve as a

lesson to other public listed companies of the consequences of poor corporate governance, and be used to improve their company's performance.

1.5 Research Methodology

A case study was used for this research. The study focused on the poor corporate governance practiced by the AB Berhad's Board of Directors from both the ethical and legal perspectives. The research for the case study was conducted by discreetly examining and viewing various financial and non financial source documents of AB Berhad to protect the identity and security of the informer.

The documents comprised the company accounts and correspondence between relevant parties pertaining to unethical transactions and dealings. Another source of primary data was derived from a number of interviews conducted with Malaysian company directors and internal and external auditors who voiced their general views on ethical business conduct.

The secondary data for the project was obtained through library research of books, magazines, AB Berhad's annual reports, articles, newspapers and from the AB Berhad's website. This took place at the International Islamic University Malaysia library and the Malaysian Institute of Corporate Governance library.

CHAPTER TWO

REVIEW OF THE LITERATURE

2.1 Definitions of Corporate Governance

According to the New Shorter Oxford English Dictionary, corporate is defined as “forming or being a corporation; having a legal existence distinct from that of the individuals who compose it” and governance as “controlling or regulating influence; controls, mastery”.⁷

Corporate governance, or, the governing of a corporation implies that the company and whoever is governing it, i.e. the directors, understand the role or the perceived role of the corporation in today’s environment, and are capable of bringing about the needed changes to meet the expectations of society in terms of conformance to regulatory authorities and to impose discipline upon oneself to achieve performance with integrity, transparency and accountability in order to satisfy the various components of the stakeholder.

In Malaysia, the High Level Committee on Corporate Governance has defined Corporate Governance as “the process and structure used to manage the business and affairs of the company towards enhancing business prosperity and corporate

⁷ The New Shorter Oxford English Dictionary, Clarendon Press, Oxford, 1993, 1, pp 515 & 1123.

accountability, with the ultimate objective of realizing long term shareholders value whilst taking into account of the interest of other stakeholders.”⁸

The above definition contains a number of key words namely:

- a) Process and structure where the code deals with not just particular procedures, but the broader framework of governance.
- b) Direct and manage where the code emphasizes the dual responsibility within the leadership structure balanced between setting the direction of the business and managing the business and affairs of the company.
- c) Business prosperity and corporate accountability.
- d) Long term shareholder value and interest of other stakeholders in which directors are accountable for the creation of long-term value and are expected to represent the interests of other stakeholders’.

2.2 The Concept of Corporate Governance

Good corporate governance should be able to control overall activities in a corporation. It should consist of a system of structuring, operating and controlling a company in order to achieve the following objectives;

⁸ Finance Committee On Corporate Governance, Report on Corporate Governance Malaysia, Ministry of Finance, Malaysia, 1999, pp.10.

- a) It should have long-term strategic goals, which can be achieved apart from being able to enhance shareholders' value by being a leader in its industry.
- b) It should provide a safe and conducive working environment for its employees and a good retirement scheme.
- c) To take into consideration the needs of the environment and local community including economic and cultural interaction with the local population.
- d) To maintain an excellent relationship with customers and suppliers in terms of the quality of service provided, considerate ordering, and account settlement procedures.
- e) To maintain proper compliance with all the applicable legal and regulatory requirements under which the company is carrying out its activities or operates.

The above concept clearly covers a wide range of interested parties, among others primarily the shareholders, and other stakeholders namely employees, creditors, regulatory bodies and the community at large.

2.3 Development of Corporate Governance

The trend of developing corporate governance guidelines and codes of the best practices began in early 1990's in the United Kingdom and in the United States in response to problems in the corporate performance of leading companies. The

Maxwell and Guinness scandals in the 1980s, for example, provided part of the impetus for the development of the Cadbury Report in Britain. These problems occurred due to the perceived lack of an effective board of directors in directing the company resulting in pressure for change from investors, particularly from the institutional investors who had suffered huge losses in their investments due to these types of companies' practices.

Lord Cadbury in the United Kingdom in the Cadbury report and the General Motors Board of Directors' Guidelines in the United States have each formulated policies which have proved to be influential sources for other guidelines and code efforts.

The Cadbury Report, for instance, is aimed at ensuring that good governance is established and observed in the corporate arena. It defines Corporate Governance as simply the system by which companies are directed and controlled.

The corporate governance concept has gained prominence in Malaysia and has been given more prominence after the Asian financial crisis. The growth of a Malaysian business from a family owned concern to a large company and the change in the structure of ownership from family ownership to diverse shareholders necessitate the appointment of professional directors and managers distinct from the majority shareholders to run, direct and manage the company concern.

Shareholders, on the other hand, want or expect the appointed officers to perform for the benefit of all shareholders particularly and other various stakeholders with the

highest degree of honesty and integrity. The directors are fully aware of these weaknesses and often exploit the situation by exercising unbridled powers to achieve private agendas all in the name of public companies.

The shareholders and other stakeholders have more recently wanted to play a more active role in corporate governance in terms of how the companies are being managed due to significant numbers of corporate failures arising from fraud, corruption and mismanagement which have directly and indirectly affected a number of interest groups including the shareholders, especially when their value in the company has reduced or in some cases where it has been completely written off and there is nothing left for them to take home.

The Board of Directors and Auditors are appointed in the Annual General Meetings by the shareholders and, as such, the shareholders being the rightful owners of the company, should be interested to know whether the elected representatives and the management of the company are carrying out their duty in accordance with the company's formulated objectives and in accordance with the rules and regulations to which they are required to adhere.

Auditors act as the representatives of the shareholders and should ensure that a proper audit is carried out to ensure the company has not deviated from its original function and objectives and should in a timely fashion (quarterly reports, for example) be communicated to the shareholders.