INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

# THE ASSOCIATION BETWEEN THE BOARD COMPOSITION AND THE CHOICE OF EXTERNAL AUDITOR: EVIDENCE FROM COMPANIES LISTED IN THE FINANCE SECTOR OF BURSA MALAYSIA

BY

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# ABSTRACT

This paper studies one of the most important corporate governance issues; board composition. The board of directors should play its monitoring role as the representative of shareholders-owners to align management's objectives with those of the shareholders'. Since there are generally two types of directors i.e., executive (inside) and non-executive (outside), we argue that the presence of outside directors would serve the purpose of an effective monitoring mechanism, because this type of director would safeguard his high reputation and would not risk his name being associated with bad practices (see Sahlman, 1990). Since his reputation is at stake, he would regard the accounting record (as indication that shareholders' interests are maximized and protected) as a very important document and thus, demand an audit of high quality into those records. Therefore, a high quality auditor serves to protect the board of directors by decreasing the chance that errors or omissions will exist in the audited financial statements. Stated differently, we argue that the presence of a higher proportion of outside directors is associated with a high quality audit, where quality is defined as the firm falling into one of the Big 4 and being specialized in particular industries. The result of the study supports the hypothesis if we define the outside director as a non-executive director. However, if we define the term more strictly, i.e., as independent non-executive director, it shows no evidence that the presence of an independent non-executive director is associated with a higher quality auditor. The paper also found an interesting result of the insignificant relation between audit quality and the institutional investor indicating the lack of shareholders activism in Malaysia.

# ملخص البحث

يتناول هذا البحث واحدة من أهم قضايا الإدارة و الرقابة المشتركة، وهي تكوين مجلس الإدارة في الشركات وهيكليته. يجب مجلس الإدارة في الشركات أن يلعب دوره الرقابي كممثل للمساهمين في التنسيق والملائمة بين أهداف إدارة الشركة و أهداف المساهمين. وبشكلاً عام، يوجد نوعان من مديري مجلس إدارة الشركات، مديرون تنفيذيون (من داخل الشركة) و مديرون غير تنفيذين (من خارج الشركة). وبناءً على ذلك فأن الباحث يثبت بأن تمثيل مديري غير تنفيذين (من خارج الشركة) في مجلس الإدارة سوف يخدم هدف فعالية آلية الرقابة وذلك بسبب أن هذا النوع من المديرين يفضل المحافظه على سمعته و لا يحب أن يخاطر بربط إسمه بأية ممارسات إدارية سيئة (راجع سآلمون 1990). وطالما أن سمعة هؤلاء المديرين تحت الرهان، فأنهم يعتبرون سجل الحسابات (مؤشر لحماية مصالح المساهمين) واحد من أهم المستندات، وبالتالي فأنها تحتاج إلى نوعية عالية من عملية المراجعة. لذلك فوجود مراجع حسابات ذو كفآءة عاليه سوف يعمل على حمايه مجلس الإدارة عن طريق التقليل من فرص وجود أخطاء أو إهمال في إظهار المعلومات في التقارير المالية المدققة. ويثبت الباحث أيضاً أن نسبة التمثيل المرتفعه للمديرين غير التنفيذين (من خارج الشركة) في مجلس الإدارة مرتبطة بنوعية مراجعي الحسابات. ويعنى بالنوعية هنا هو تعاقد الشركة مع إحدى كبرى شركات المراجعة الأربع ( لمراجعة حسابات الشركة) والتخصص في صناعات محددة. وقد توصل البحث إلى نتائج تدعم وتؤيد فرضية البحث وذلك عندما أثبت أن المديرين من خارج الشركة هم المديرون غير التنفيذين. من ناحية أخرى، إذا تم إعتبار المديرين من خارج الشركة وبشكل أكثر دقة أنهم المديرون غير التنفيذين المستقلين، فأن النتائج التي توصل إليها البحث تؤكد عدم وجود إرتباط بين نسبة تمثيل المديرين غير التنفيذين المستقلين في مجلس الإدراة بنوعية مراجعي الحسابات. ولقد توصل البحث أيضاً إلى نتيجة أخرى مهمة وهي وجود علاقة بين نوعية مراجعي الحسابات و بين المستثمرين الجماعيين، مؤكداً على عدم وجود مساهمين مؤثرين في الشركات الماليزية.

# APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate in scope and quality, as a thesis for the Master of Science in Accounting.

Hafiz Majdi Abdul Rashid
Supervisor

I certify that I have read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate in scope and quality, as a thesis for the Master of Science in Accounting.

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Mansor Ibrahim
Dean, Kuliyyah of Economics and Management Sciences

# DECLARATION

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

Name: AHMAD ZAMRI BIN OSMAN @ HUSSIN

Signature:……………………………. Date:………………………

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**The Association between the Board Composition and the Choice of External Auditor: Evidence from Companies Listed in the Finance Sector of Bursa Malaysia**

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In the name of Allah, the Most Compassionate and the Most Merciful. Praise be to Allah, Lord of the Universe and to His Messenger Muhammad PBUH.

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| | |
|---|---|
| ADB | Asian Development Bank |
| AMEX | American Stock Exchange |
| BNM | Bank Negara Malaysia |
| CEO | Chief Executive Officer |
| CFO | Chief Financial Officer |
| DAC | Discretionary accruals |
| DTT | Deloittee Touche Tohmahatsu |
| ERC | Efficient response coefficient |
| EY | Ernst and Young |
| FSA | Financial Service Authority |
| GAAP | Generally Accepted Accounting Standards |
| GMI | Governance Metrics International |
| IMF | International Monetary Fund |
| IPO | Initial Public Offerings |
| KLSE | Kuala Lumpur Stock Exchange |
| MICG | Malaysian Institute of Corporate Governance |
| MSWG | Minority Shareholder Watchdog Group |
| NEP | National Economic Policy |
| NYSE | New York Stock Exchange |
| OECD | Organization for Economic Co-Operation Development |
| OLS | Ordinary least square |
| PCTGINE | Percentage of Independent Non-Executive (director in a board) |
| PCTGNE | Percentage of Non-Executive (director in a board) |
| PWC | PricewaterhouseCoopers |
| SEC | Securities Exchange Commission, United States of America. |
| UK | United Kingdom |
| UKLA | United Kingdom Listing Authority |
| US | United States of America |
| USD | US Dollar |
| VIF | Variance Inflation Factor |

# CHAPTER 1: INTRODUCTION

## 1.1 Background of the Study

In the wake of recent corporate scandals involving those entrusted to oversee the operation of a company, i.e., management, various measures have been suggested to control and monitor such a problem from recurring. These issues are among the important corporate governance problems recently discussed. The President of the World Bank, James D. Wolfenshon, stressed the importance of corporate governance by saying that "the governance of corporations is as important in the world economy as government of countries"[1].

Although the interest in corporate governance is quite new to Malaysia, it has become the subject in the Western world for the past 50 to 60[2] years arising out of the way a company is funded (i.e., equity capital or debt capital). Gregory and Simms (1999) stated that "[p]roviders of corporate finances… require assurance that their investment will be protected and will generate return. These assurances are at the heart of what effective corporate governance is all about". Narrowly defined, corporate governance concerns the relationships between corporate managers, directors and shareholders. A broader definition would encompass the combination of laws, regulations, listing rules and voluntary practices that enable the corporation to attract capital, perform efficiently, generate profit and meet both legal obligations and general expectations

[1] http://www.worldbank.org/html/fpd/privatesector/cg/aboutus.htm.
[2] "The interest in corporate governance grew in the United States after World War II with huge demand for capital by corporation" (Lyn, 2001). Downloaded from www.financeasia.com/articles/9ABE1A26-BI2B-11D5-81D20090277EI74B.ctm

(Gregory and Simms, 1999). Millstein (1998)[3], in her opening remark at the World Economic Forum in Davos, Switzerland described the corporate governance as follows:

> "The term 'corporate governance' has many definitions. It can broadly encompass all of the corporation's relationships: relationships among capital, product, service and human resource providers, customers and even society at large. It can encompass all the laws designed to hold the corporation accountable to shareholders and the public, as well as the workings of the market for corporate control. It can refer to audit practices and accounting principles, and it can refer to shareholder activism. Even more narrowly, the term can be used to describe just the role and practices of the board of directors"

Therefore, it is the aim of this paper to present the role and relationship of the external auditor and the board of director as a monitoring mechanism due to its dearness to the corporate governance issue (as underlined above).

The paper attempts to examine the association between the board composition and the choice of external auditor, in the financial institution setting. Board composition has always been the subject of corporate governance study in examining the effectiveness of boards. Within an agency theory framework, the presence of outside directors in a particular board is thought to provide an effective monitoring role as agency theory argues that the manager has the tendency to act in a self-interested manner in which the result might deviate from the shareholders' interests. Meanwhile, outside directors are generally highly reputable members of the business community who view directors' role as a mean to further develop their reputation (Fama and Jensen, 1983a). However, they might suffer reputational and monetary damage from their service as outside directors due to 'frivolous lawsuits'[4] (Sahlman, 1990). Therefore, the higher proportion

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[3] "The Evolution of Corporate Governance in the United States," Remarks to the World Economic Forum, Davos, Switzerland (February 2, 1998) downloaded from http://www.transparency.org/iacc/9th_iacc/papers/day2/ws3/d2ws3/hjgregorymesimms.html..

[4] A lawsuit that could jeopardize the reputation and exhaust the resources (money and time) of a director although it has no legal substance. Sahlman (1990) said that "frivolous lawsuits, all too common, require

of outside directors in a board would induce greater monitoring because this type of director would safeguard his high reputation and would not risk his name being associated with bad practices. This, in turn, impedes the incentive of the manager to act opportunistically.

The board of directors is tasked to supervise the management of a company. However, in undertaking these supervising and monitoring functions, there exists a need for a supporting structure as the board of directors themselves cannot or is simply impossible and impractical to do the necessary detailed work of monitoring and supervisory roles. The Dey report, issued by the Toronto Stock Exchange provides a practical corporate governance definition regarding the need for a supporting structure;

> "… the structure and the process used to direct and manage the business affairs of the corporation with the objective of enhancing shareholder value…"[5]

As mentioned above, the structure can come in the form of an external auditor, management and internal auditor. The Basel Committee on Banking Supervision (1999) sets some important roles of the external auditor as a means to enhance the effectiveness of monitoring by the board. Thus, the external auditor can become a source of supporting structure for the board of directors in ensuring the proper monitoring of management.

While audit acts as a systematic examination process, various studies have found that the auditor could succumb to a lower quality audit due to various reasons, pressure from management, survival, inexperience, lack of expertise; to name a few. However,

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the same reasoned response as legitimate claims". At the very least directors lose control over time (if not money) attending to the lawsuit. Often, to save on legal fees, the suits were settled out of court although the chance of winning is high. However, this solution implies culpability which damages a director's reputation. According to Sahlman (1990), the frivolous suits are growing partly due to the legal system which is "relatively easy to file suit, but difficult to get rid off".

[5] http://www.transparency.org/iacc/9th_iacc/papers/day3/ws7/d3ws7/rmnewsome.html.

literature on audit quality has documented evidence that the higher audit quality is normally associated with the brand name auditor. Similar more refined studies also found that brand-name specialist auditors, i.e., brand-name auditor who specialized in a certain industry, command better audit quality. The risk borne by outside directors necessitates the demand for quality information (free from financial misstatement or fraudulent reporting) which is generally provided by quality auditors. Since auditing serves to increase the credibility of the financial statement and its reliability as a monitoring device (Abbott and Parker, 2000), a high quality auditor should serve to protect the board of directors by decreasing the chance that errors or omissions will exist in the audited financial statement. Combining both the literature on board composition and audit quality, this paper argues that the board of directors comprising of higher proportion of outside director would choose a higher quality auditor (in the form of specialist brand-name auditor) to perform the intended monitoring role.

## 1.2 Objective of the Study

The study has two objectives which are related to the reason financial institution is chosen and another objective concerning the effectiveness of Bursa Malaysia listing requirement. Firstly, it tries to examine whether the financial institution (which has many stakeholders) in Malaysia ignores the basic principal-agent relationship (i.e., shareholders-management). By ignoring, it means that the management pursues its own objective thus disregarding the shareholders' objectives. In pursuing its own objective, it is expected that management will choose a lower quality auditor in order to conceal its self-opportunistic behaviour. Thus, the higher the number of executive directors in a board (i.e., the lower the number of the outside director), the lower the likelihood that a quality auditor is hired. This will be tested by finding evidence as to the association between the outside/inside directors of the financial institution and the choice of the auditor as a monitoring mechanism. Secondly, as Bursa Malaysia has stressed on the importance of independent non-executive directors, the study will analyse whether such directors will make better monitors in term of appointing quality auditors. Bursa Malaysia has prescribed that every listed company must abide by the guidelines with the objective of proper governance.

### 1.3 Motivation of the Study

The study is conducted due to the need for specialized expertise for specialized industries. A specialized industry such as financial institutions needs specialist auditors because previous studies suggest that specialization is important (e.g. Craswell et al., 1995; Shockley and Holt, 1983). Apart from that, many studies in the financial institution setting focus on the relationship either between the financial institution and depositors or between the financial institution and government (i.e., regulatory body), thus ignoring the normal agency relationship of the financial institution and shareholders (Davis, 1995). Therefore, this study tries to look into this relationship. In addition, the financial institution is seen as the engine of growth for a country, especially in Asia. Therefore, the issue of governance, generally, and board composition, specifically, is very important as slight ‘misgovernance’ of the financial sector would affect the health of a country.

It is also interesting to study the financial institution because it has many direct stakeholders which put them in a lot of conflict-of-interest situations. Therefore, my study will provide an insight into whether the shareholders' interests are safeguarded given that the highly regulated sector such as banking is mostly focusing on protecting depositors. The financial institution is also chosen due to its role in the Asian financial crisis and was regarded by many as the major contributor to the financial turbulence in 1997.

### 1.4 Organization of the Study

The study consists of six chapters. Chapter two discusses the literature review on the board composition and audit quality. In this chapter, the paper starts by giving an overview of different prevailing perspectives permeating the discussion of board's responsibility. Four major theories are presented and the researcher chooses the agency theory to advance his argument due to the nature of the paper emphasizing the monitoring aspects as opposed to the measuring financial performance of a firm. Then the previous literature is presented where mostly governance literature dominates the discussion on the board of directors. The board of directors' discussion is introduced to show the importance of having outside directors as a monitoring mechanism. The literature review on outside directors is presented evidencing the advantage of appointing outside directors onto a board. The paper, then, further argues that having outside directors alone is insufficient to ensure proper monitoring. As proposed by Baysinger and Butler (1985) quoted in Clifford and Evans (1997), a distinction is made between an independent outside director and an outside director by categorizing board of directors into a three-scale classification (i.e., inside, outside and grey[6]). The literature on audit quality follows where the seminal work by DeAngelo's (1981) gives

[6] Grey director is a director whose independence can not be determined. For full discussion please refer to Chapter 2.1.

a definition of audit quality which provides a precursor to the literature discussion. Taking a cue from the various literature, audit quality is surrogated by the brand name auditors, i.e., normally termed the Big 4[7]. Therefore, any company hiring these four firms signals that they are receiving a quality audit. We further classify the Big 4 firms into specializations based on different definitions of specialization provided by Palmrose (1986); Craswell et al. (1995) and Balsam et al. (2003).

Chapter three discusses the institutional background, i.e., the financial institution. It comprises two sub-chapters; (i) general financial institution discussion and (ii) focusing on banking industry. The general financial institution sub-chapter explains why governance in financial institutions is important. Specifically, the study outlines 3 reasons; firstly the nature of financial institution as intermediaries; secondly the financial institution as the main fund provider mobilizing a country; and thirdly the role it played in the Asian financial crisis. The second sub-section banking industry, presents some literature on agency theory related to the banking industry. Specifically, it reviews some of the issues which are industry-specific to banking. Since banking has unique extra relationships (i.e., depositor, regulator, shareholder, management); not confined to the normal agency problem of principal-agent, a lot of previous studies tend to assume away this normal agency relationship in banking (relationship between shareholder and management). Chapter four discusses the research methodology and

[7] Across this paper you will see that the number of brand name auditors seems inconsistent ranging from the Big 4 to the Big 8 depending on the period where the study took place. This is primarily due to mergers of the audit firms. Originally, the Big 8 consisted of Arthur Andersen (AA), Arthur Young (AY), Coopers & Lybrand (CL), Deloitte Haskins & Sells (DHS), Ernst & Whinney (EW), Peat, Marwick, Mitchell (PMM) Price Waterhouse (PW) and Touche Ross (TR). Then the term changed to Big 6 when AY merged with EW and DHS merged with TR in 1989 resulting in two new entities called Ernst and Young (EY) and Deloitte Touche (DT). Second round of mergers in 1997 between CL and PW resulted in a new firm called PriceWaterhouseCoopers (PWC). Then it became the Big 4 when AA ceased to exist mainly due to the Enron debacle. Presently, the brand name auditors better known as the Big 4 are DT, EY, PMM (better known as KPMG) and PWC.

research design. This chapter presents audit quality, which is measured using trichotomous measure, as the dependent variable. Meanwhile, the hypothesized variable of outside director is tested twice, in order to examine two different hypotheses. The first hypothesis takes percentage of non-executive director as outside director while the second hypothesis takes independent non-executive as the outside director. Chapter five discusses the empirical results, where two regression tests are conducted to examine the two hypotheses. The results show that the first hypothesis is supported, while second hypothesis is not. The full results are discussed in detail in Chapter five. Chapter six concludes by outlining some contributions and limitations of the study. It points out, among others, the need to clearly define independence because this type of director would probably merely act as a proxy to a real director, thus making his status as non-independence.

# CHAPTER 2: LITERATURE REVIEW ON BOARD AND AUDIT QUALITY

As discussed in the introduction chapter, board needs a supporting structure, i.e., auditor, in order to perform monitoring task more effectively. Since director's reputation is at stake, he would not like his name being associated with bad practice by management, thus demands quality audit. Therefore, this chapter mainly presents the literature on what effective board composition entails and then, discusses the audit quality literature which presents several methods of determining quality auditor. This chapter comprises 4 sub-sections, i.e., general discussion on the board composition, discussion on theories of corporate governance, literature on board composition, and literature on audit quality. The first sub-section provides general discussion on board independence. It sets out some definitions of independence according to several authorities (e.g., Bursa Malaysia, Governance Metrics International etc). The second sub-section provides several theories prevailing in the discussion on the appointment of boards of directors. Specifically, four theories are discussed, i.e., the agency, stewardship, resource dependency and stakeholder theories. At the end of the discussion, the paper proposes that, the agency theory would be used mainly due to its dearness to the issue of conflict-monitoring that exists between agents and principles. Furthermore, the study which tries to investigate the association between board composition and a monitoring mechanism (i.e., auditor in which quality is generally surrogated by brand name audit firms), renders the agency theory more relevant in discussing this paper[8]. The third sub-section presents some literature reviews

[8] As discussed later in this paper, other theories generally try to investigate the association between board composition and financial performance. Although a few papers argue that when a board chooses

concerning the effect of appointing certain types of directors onto a board. Lastly, the fourth sub-section introduces several works on audit quality and outlines several ways of how audit quality is measured.

### 2.1 General Discussion on Board Independence

Corporate governance literature has always discussed board independence as one of the mechanisms to ensure good governance. The issue of board independence is so important to the extent that it was made as one of the priorities for reform in the Asian Corporate Governance Roundtables[9].

The Asian Roundtable on 4th December 2003 released a "White Paper on Corporate Governance in Asia" (hereinafter called the White Paper), where one of the five key issues is the responsibility of the boards. The White Paper (2003:47) admitted that legal norms could always be defeated by behavioural norms by saying:

> "No legal norms, however refined, can contemplate every situation in which a director might find himself. A director wishing to abuse his position, either for his own benefit or that of a manager or shareholder, can often mask his own misbehaviour by going through the motions of proper deliberation prescribed by legal norms".

However, it adds that within the Asian context, legal norms through regulators such as securities commissions and stock exchanges should play a more active role in ensuring good corporate governance particularly regarding board independence. The White Paper (2003:48) on paragraph 260 asserts that "…for both cultural and practical

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high quality audit firms it would result in higher financial performance, in certain situation the board would opt for 'less-than high' financial performance especially when improper accounting practice by management is expected (see for e.g., Beekes et al., 2004).

[9] The corporate governance roundtable was established jointly by the OECD and the World Bank in their effort to promote policy dialogue on corporate governance. The roundtable was set up according to region, i.e., Asia, Russia, Latin America, South-East Europe and Eurasia. Each regional roundtable will employ the OECD Principles on Corporate Governance as a framework for developing a regional white paper addressing both general corporate governance issues and matters of specific concern to respective regions.

reasons, Asian shareholders often prove reluctant to litigate or to assert formally their rights. This reluctance places greater emphasis on regulators and prosecutors and raises capacity and infrastructural challenges for Asian corporate governance corporate". This necessitates a rather "hard and fast" rule on the minimum number of independent directors on a particular board.

The White Paper has devoted 65 paragraphs (paragraph 275 to 339) concerning recommendations to improve the corporate governance issue in the general board-related area including 10 paragraphs (paragraph 318 to 327) on the specific independent board issue. Although there is no specific recommendation on the ideal number of independent directors on a board, it did point out that a board "…should consider assigning sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest"[10]. The paper further provides some additional suggestions such as "…having non-executive/independent directors *that*[11] constitute a majority of the board and continuously revising the membership of the board. This proposal may achieve greater board independence…"[12].

Shamser and Annuar (1993) define board composition as the proportion of outside directors to the total number of directors. On this matter, Haniffa and Cook (2000) explain further that the outside director is a non-executive director who is not the employee of the company. This necessarily makes a distinction between the executive and non-executive, i.e., the executive is an employee of the company while the non-

[10] the White Paper on Corporate Governance in Asia, paragraph 323.
[11] Italics added.
[12] Ibid, paragraph 326.

executive is not the company's employee. Therefore, classifying board members as executive or non-executive is straight forward. However, defining the term independent is problematic. Governance Metrics International (GMI)[13] asserts that by being a non-executive member, a director is not necessarily free from other relationships with the company that might cloud his or her independence. Therefore, a more refined definition for board composition must take into consideration the independence issue as the monitoring process would most likely be more effective if the outside/non-executive director is also independent. Matters such as conflict of interest require a real independent decision which could only be provided by an independent non-executive director and not just a non-executive alone because non-executive director might be appointed due to being a substantial shareholder[14]. The White Paper in paragraph 319 asserts that "…because controlling shareholders often choose the entire board, the real objectivity and independence and the real value of nominally independent (*i.e., non-executive*)[15] directors can be undermined".

GMI simplifies the definition of independent director as someone whose connection to the company is only his or her board seat (see Appendix I). In other words, an independent director does not have any relationship at all with the company except his appointment as a director. However, within the Malaysian context, the Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange or KLSE) in its listing requirement

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[13] GMI is an independent corporate governance rating agency. They claim to be a "pioneering accountability ratings" agency. They can be visited at http://www.gmiratings.com/.

[14] Throughout this paper, reader will see many discussions on outside and inside director. Readers will also see some other related terms used by previous studies such as executive director, non-executive director, independent non-executive director, non-independent non-executive director, affiliated director and grey director. Briefly, the outside director has two types, i.e., independent outside director (or independent non-executive), and non-independent outside director (or non-independent non-executive). Non-executive director whose independence is indeterminable is called grey director. Meanwhile affiliated director is, briefly, a non-independent outside director.

[15] Italics added.

provides a definition of independent director as "…a director who is independent of management and free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interest of an applicant or a listed issuer"[16]. It further provides several specific instances on whether a director is considered independent or not. For example, he is not independent under the Bursa Malaysia definition (although he is a non-executive) if he is a major shareholder of the applicant, listed issuer or any related corporation of the listed issuer (Appendix II). However, more importantly within the context of this paper, the Bursa Malaysia states that the applicant, i.e., the company wanting to be listed must ensure that at least 2 directors or one-third of the board of directors, whichever is higher, are independent directors. If the number of directors of the applicant is not 3 or a multiple of 3, then the number nearest one-third shall be used[17]. Within the Malaysian bank setting, Bank Negara Malaysia (BNM); the central bank of Malaysia has also issued a BNM's Guideline following the Bursa Malaysia regulation. In the BNM's Guidelines (BNM/GP1), it requires that at least 2 directors be independent non-executive directors. The primary purpose of appointing the minimum number of independent directors, according to the guidelines, is to oversee the operation of the business and to make sure that shareholders' interests are safeguarded.

Literature on the effect of appointing an outside director on a board has been diverse. Researchers have studied the result of appointing outside directors on the choice of the external auditor (Beasley and Petroni, 2001); on stock ownership (Yusoff and Ahmad,

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[16] Bursa Malaysia Listing Requirement, Chapter 1, Part A, 1.01-Definition, page 1-04. The difference between applicant and listed issuer refers to the stage of application. An applicant is a person or a company who is applying for admission of its securities, while a listed issuer is any company, other person or undertaking (including a trust), whose securities have been admitted to the Official List.
[17] Ibid, Chapter 1, Part E-Other Requirements, 3.14-Independent directors, page 3-07.