Abstract

The establishment of a code of corporate governance is needed to cope with increased global competition. In market-oriented economies, the traditional prescriptive legal rules and regulations afford minimal protection to corporate enterprises. In a number of jurisdictions, codes of corporate governance have been implemented and later, subsequently strengthened to enable companies to face increased international competition.

In this context, Malaysia as in many other Asian countries has also embarked on various legislative reforms to strengthen its corporate governance framework. From 2000 to 2012, the regulatory framework on corporate governance has undergone three major changes moving from the reformation, strengthening, and finally, the further enhancement phase. In the latest reform, the Securities Commission in Malaysia introduced the Malaysian Code on Corporate Governance 2012. The 2012 Code sets out broad principles and specific recommendations on structures and processes that companies can adopt to make good corporate governance as an integral part of their business dealings. The essence of the new Code is to further strengthen a culture of good corporate governance. It has eight principles with a simplified structure. The purpose of the article is to examine the changes to corporate governance introduced by the new Code and its implications to the corporate sector.

Keywords: Corporate governance, Reforms, Best practices

1. Introduction

Corporate governance is important in the development of financial markets (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1997; 1998; 1999; 2000). The financial development of
markets in these countries is supported by a strong legal framework and enforcement. These developments provide better protection to investors.

Corporate governance became a major concern following the East Asian 1997 to 1998 financial crisis. Corporate governance practices that are questionable exposed the vulnerability of a number of countries to the crisis and further exacerbate the crisis once it began. Research has shown that corporate governance is an important factor in the development of financial markets and the value of the firm (Mitton, 2002; La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1997; 1998; 1998b; 2000). In this context, Malaysia has also placed corporate governance as a priority and a core component in its strategic plan for the development of its capital market (Singh, 2013). The Malaysian Code on Corporate Governance 2012 (“MCCG 2012”) further delineates the future corporate governance landscape of the country. The basic objective of the MCCG 2012 is to promote a strong corporate governance framework through both an enhanced self and market discipline along with a compliant corporate governance culture.

Earlier, the 1997 Asian financial crisis had acted as a catalyst to transform the corporate governance regulatory framework in many countries in Asia, including Malaysia. In Asia, the results of the transformative effects on the corporate governance systems are significant. It has led to a stronger regulatory governance framework, an increase in the number of regulators with greater government support, the establishment of new institutions to monitor and enhance corporate governance, an increase in shareholder activism, and a number of positive changes to market participants’ attitudes and behavior (OECD, 2011). Undoubtedly, investors, shareholders, and regulators recognize the positive benefits associated with good corporate governance standards. Among these benefits are a higher level of transparency and disclosure, improved risk management as well as enhanced control mechanisms that are able to attract more domestic and foreign investment. The Malaysian regulators recognized the importance of a strong corporate governance framework.

In seeking to set a higher level of corporate governance, Malaysia as in most Asian countries, has adopted the OECD Principles of Corporate Governance to develop its corporate governance codes, listing rules, and regulations (OECD, 2011).

**Towards Reforming Corporate Governance**

At the first stage of the development, Malaysia introduced a Code on Corporate Governance in March 2000. The Malaysia Code on Corporate Governance 2000 (“MCCG 2000”) provides a constructive and flexible approach as it strives to raise the standard of corporate governance.
Paragraph 1.3 of the Introduction to the MCCG 2000 sets out the principles and best practices on structures and processes that companies may use in their operation to set up an optimal governance framework. These structures and processes exist at the micro-level. It is related to issues that concerns the composition of the board, procedures for recruiting new directors, remuneration of directors, the use of board committees, their mandates and their activities.

Such prescriptive approach allows directors to focus on form, rather than exercising their judgment on what corporate governance practices are best for their companies. In most cases, to comply with best practices is normally associated with the act of ticking a series of boxes to show that the directors have complied with the prescribed best practices. As a result, the prescriptive approach does not realistically ensure that the company has complied with the procedures on corporate governance.

The MCCG 2000 is premised on a prescriptive approach to corporate governance. Basically, the MCCG 2000 consists of four major recommendations, namely: (i) The broad principles of good corporate governance in Malaysia; (ii) The best practices in corporate governance; (iii) Exhortations to investors and auditors to enhance their role in corporate governance; and (iv) Explanatory notes to the principles and best practices set out in Parts (i) and (ii); and exhortations set out in Part (iii). In addition, Part IV also sets out best practices directed at listed companies that do not require companies to explain circumstances justifying departure from best practices.

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

Part 1 sets out broad principles of good corporate governance for Malaysia. The main purpose of the principles is to allow companies to apply the principles in a flexible manner and with common sense approach that is based according to individual companies’ circumstances. The listing requirements of the KLSE require companies to include in their annual report a narrative statement of how they apply the relevant principles to their particular circumstances. This allows
sufficient disclosure so that investors can assess a companies’ performance and governance practices, and respond in an informed way.

On the other hand, Part 2 sets out best practices in corporate governance for companies. It identifies a set of guidelines or practices intended to assist companies in designing their approach to corporate governance. While compliance with best practices is voluntary, companies will be required as a provision of the listing requirements of the KLSE to state in their annual reports, the extent to which they have complied with the best practices set out in Part 2 and explain any circumstances justifying departure from such best practices.

Part 3 focuses on the exhortations. It is not addressed to listed companies but to investors and auditors to enhance their role in corporate governance. These are purely voluntary in nature.

The final section or Part 4 provides explanatory notes to the principles and best practices set out in Parts 1 and 2 and exhortations set out in Part 3. Additionally Part 4 also sets out best practices directed at listed companies that do not require companies to explain circumstances justifying departure from best practices.

Conversely, Paragraph 15.26 of the KLSE Listing Requirements require all listed companies to state in their annual report how they have applied the principles set out in Part 1 of the Code and the extent to which they have complied with the best practices set out in Part 2 as well as identify and give reasons for any areas of non-compliance, and where applicable, state the alternative practices adopted.

In respect of Parts 1 and 2, boards are not expected to comment separately on each item of the Code with which they are complying, but areas of non-compliance will have to be dealt with individually.

It is recognized that smaller listed companies may initially have difficulty in complying with some aspects of the Code. The boards of smaller listed companies who are not able to comply with some parts of the Code is allowed some degree of freedom as they can provide reasons for non-compliance.

Sanctions for non-disclosure
Where a company fails to disclose the matters set out in para 4.1 in its annual report, it is open to the Exchange to take any action against the listed entity or its directors as set out in the listing requirements and section 11 of the Security Industry Act 1983.

Overall, the MCCG 2000 codified the principles and best practices of good governance and described the optimal corporate governance structures and internal processes. It represents an important initiative aimed at increasing the standards of corporate governance. This is based on the experiences of other jurisdictions such as stated by the Hampel Committee where there is a general consensus that the Cadbury Code of Best Practices has resulted in higher standards of governance and greater awareness of its importance along with full disclosure. The MCCG 2000 has, to a larger extent, succeeded in raising the standard of corporate governance in the Malaysian corporate sector. Shareholders and other stakeholders are able to assess, determine, and have a more accurate report of the standards of corporate governance of listed companies based on the mandatory reporting compliance with the MCCG 2000.

Nevertheless, changes in the domestic and international capital markets require greater efforts to strengthen corporate governance practices. A review of the MCG 2000 was conducted to achieve this purpose. In the 2008 Budget speech, former Prime Minister, Dato’ Seri Abdullah Ahmad Badawi announced that “the Code is being reviewed to improve the quality of the board of public listed companies (PLCs) by putting in place the criteria for qualification of directors and strengthening the audit committee, as well as the internal audit function of the PLCs…. To ensure the effectiveness of the audit committee of PLCs, executive directors will no longer be allowed to become members of the audit committee. In addition, the internal audit function will be mandated for all PLCs, and the board of directors will be responsible for ensuring the adherence to the scope of internal audit functions…."

**Strengthening Corporate Governance**

The Malaysian Code on Corporate Governance 2007 (“MCCG2007”) introduced some significant changes to the MCCG 2000. The primary purpose of the changes is to strengthen the board of directors and audit committees. The MCCG 2007 aimed to ensure that the board of directors and audit committees discharge their roles and responsibilities in a more effective manner. The changes also listed the eligibility criteria for appointment of directors and the role of the nominating committee.

These amendments listed out the eligibility criteria for appointment as an audit committee member, the composition of audit committees, the frequency of meetings and the need for continuous training. In addition, all public listed companies are required to conduct an internal audit. The amendments also clarified the reporting line for internal auditors.

**Further Enhancement of the Standard of Corporate Governance**
The Malaysian Code on Corporate Governance 2012 (“MCCG 2012”) seeks to raise the standard of corporate governance to a higher level to face the challenges posed by rapid global economic development. It advocates the adoption of standards that go beyond the minimum prescribed by regulation. However, observance of the MCCG 2012 is voluntary in nature. All public listed companies listed on the Kuala Lumpur Stock Exchange are encouraged to adopt the principles and recommendations of the MCCG 2012. However, listed companies are required to explain in their annual reports how they have complied with the recommendations of the MCCG 2012. Listed companies are required to explain and justify the reasons for non-observance of any of the recommendations.

The MCCG 2012 seeks to strengthen the structure and composition of the board. It duly recognized the role of directors as responsible fiduciaries, effective stewards and guardians, and compliance with the laws and ethical values. It recommended that companies adopt certain structures and processes to allow good corporate governance to become an integral part of its business dealings and culture.

The MCCG 2012 attempt to strengthen the following key areas: - (a) roles and responsibilities of the board. The board is required to formalize ethical standards via a code of conduct and ensure that the company strategies promote its sustainability; (b) composition of the board. The board is required to set up a Nominating Committee. It is chaired by a senior independent director, who is responsible to oversee the selection and assessment of directors. The Nominating Committee is responsible for developing a set of criteria that includes policies that formalize its approach to diversity of the board; (c) Independence of independent directors. The maximum tenure of independent directors is a cumulative period of nine years. Upon completion of the nine years, such directors can be re-designated as non-independent directors or in exceptional circumstances; the shareholders may decide that an independent director can remain in that capacity after serving a cumulative of term of nine years. The board must provide strong justification to the shareholders and approval from the shareholders should be obtained on an annual basis. The cumulative period of nine years will begin from the time when a person is first appointed as independent director of a company. In addition, the positions of Chairman and CEO should be held by different individuals. If the Chairman is not an independent director, the board should comprise a majority of independent directors.

The MCCG 2012 focusses on the adoption of standards that far exceeds the minimum prescribed by regulation. Companies voluntarily observe the MCCG 2012. However, listed companies are required to report on their compliance with the MCCG 2012 in their annual reports. The MCCG also stressed on clarifying the role of the board in providing leadership, and enhancing board effectiveness. It encourages companies to adopt good corporate disclosure policies. Further, it encourages companies to make public their commitment to respecting shareholder rights.
These changes are based on the following reasons: - to further safeguard investors’ confidence; develop markets that are fair, orderly, and transparent; and to ensure more consistency and equivalence of regulatory outcome (Singh, 2013). The process to reform the MCCG 2000 was also prompted by the convergence of global corporate governance standards. This arises from increased cross-border activities and investment flows that in turn, has motivated many countries to adhere to international standards of corporate governance in order to attract domestic and international capital via a country’s higher level of competitiveness.

Shareholder rights

It is notable that the Listing Requirements is amended to prevent companies to impose restrictions on proxy appointment by shareholders. In addition, the amendment to allow the registered shareholder to appoint multiple corporate representatives is significant (Asian Corporate Governance Association, 2011). Nevertheless, the function of the two-proxy rule is not clear since a standard rule is absent. The issue that arises is whether the name of the beneficial owner should be the beneficial owner or the trustee (Asian Corporate Governance Association, 2011).

Role of institutional investors

The MCCG 2012 recommended the establishment of a new code for institutional investors and the setting up of an umbrella body for institutional investors. This is useful as it allows institutional investors to participate more actively in corporate governance rather than adopting a “voting by feet” approach where local institutional investors’ level of activism is low.

The Board’s role in governance

The MCCG 2012 mandates the separation of the position of the chairman and the CEO. However, the majority of listed companies in Malaysia are either family-controlled or state-owned. Thus, it is a challenge to have an independent chairman who is loyal to the majority stakeholder.

The Association of South East Asian Nations (ASEAN) Capital Market 2015

In line with the aspiration of its ASEAN neighbor, Malaysia attempt to raise its corporate governance standards to a much higher level. In 2004, at the ASEAN Capital Markets Forum, the 10 member ASEAN countries have agreed to integrate the ASEAN capital markets by 2015. There are two methods to increase the corporate governance standards and practices. They consist of the ASEAN Corporate Governance Scorecard and the ranking of corporate governance of the regional grouping public-listed companies. A number of steps have been taken to publicize ASEAN companies with high corporate governance standards at the international level.
Generally, the ASEAN measures indicate that ensuring good corporate governance standard is no longer confined to individual member countries, even though with their own domestic scorecards, rather it is cross national boundaries.

In this context, Malaysian companies have also published annual reports on corporate social responsibility. Malaysia has also signed the IOSCO’s Multilateral Memorandum of Understanding to participate in cross-border enforcement and international collaboration such as exchanging information among regulators such as beneficial ownership and control structures. The Code of Corporate Governance in Malaysia is applied on a compliance basis where the KLSE requires a listed company to disclose whether it has complied with the Code.

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

The establishment of board committees is mandatory for listed companies by law, regulation, or listing rules. In most Malaysian companies, board committees consist of a majority of independent directors.

According to the OECD Principles, directors who serve on too many boards are not able to perform effectively. In Malaysia, the maximum number of directorships that an individual can hold in public listed companies is 10 and for non-listed companies, 15. The new changes seek to ensure that board members devote sufficient time and energy to their work.

**Conclusion**

Companies continue to remain vulnerable to distress if a financial crisis occurs in the future. Legal reforms are generally slow in nature. Consequently, this offers minimal protection to shareholders. On the other hand, strong corporate governance can provide greater legal protection, particularly when there is extreme financial distress.

The constant change in market dynamics, global economic developments, and the need to continuously strengthen the effectiveness of the corporate governance framework was the main rationale for revision and subsequent replacement of the MCCG 2007. The new structure in the MCCG 2012 provides greater clarity, more information, and facilitates simpler reading. Each principle in the MCCG 2012 is followed by recommendations and commentaries. The principles involve broad concepts underpinning good corporate governance that companies apply.
References


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