

Corporate Governance: Theory and Some Insights into the Malaysian Practices

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ABSTRAK

Objektif makalah ini ialah menerangkan maksud tadbir urus korporat (CG) dan bersama-sama dengan beberapa pandangan menerangkan mengenai tren dan perkembangan CG di Malaysia semenjak krisis kewangan 1997-1998. Makalah ini membincangkan secara ringkas pelbagai peserta CG, dan memberi tumpuan pada mekanisme CG, pemilikan dan kawalan, dan masalah agensi, lembaga pengarah, ketelusan korporat, etika, dan tanggungjawab sosial, hubungan pelabur dan aktivisme pemilik saham. Lembaga pengarah sebagai ejen pemilik telah dikenalpasti sebagai mekanisme utama memastikan adanya CG yang kukuh. Antara lain, dalam konteks amalan korporat Malaysia, Kod Tadbir Urus Korporat (Code of Corporate Governance) telah diperkenalkan pada Mac 2001 dengan perhatian khusus diberikan kepada amalan lembaga. Perubahan utama lain termasuk pemantapan piawai perakaunan pada tahun 1997 melalui penubuhan Malaysian Accounting Standards Board (MASB), yang diletak di bawah Financial Reporting Act 1997 (FRA) dan peningkatan nota amalan (practice notes) oleh Bursa Malaysia (BM). Pihak berkuasa pengawal atur (regulatory authority) juga telah meneliti semula Securities Industry Act 1983, khususnya Take-Over Code (TOC) dengan memindanya pada tahun 1999.

ABSTRACT

The objective of this article is to explain what is Corporate Governance (CG) and together with some insights on the trends and development of corporate governance in Malaysia since the 1997-1998 financial crises. This article discusses briefly the various participants in CG, and focuses on CG mechanisms, ownership and control, and the agency problem, the board of directors, corporate transparency, ethics, and social responsibilities, investor relations and shareholder activism. The board of directors as the agent of the owners have been identified as the key mechanism in ensuring that sound CG is in place. In terms of Malaysian corporate practices, among others, the Malaysian Code of Corporate Governance was introduced in March 2001, giving particular attention in areas concerning board practices. Other key changes seen were the strengthening of accounting standards in 1997 via the establishment of the Malaysian Accounting Standards Board (MASB) under the Financial Reporting Act 1997 (FRA) as well as the enhancement of practice notes by Bursa Malaysia

(BM). The regulatory authority also undertook a review of Securities Industry Act 1983, in particular, the Take-Over Code (TOC) via its amendment in 1999.

INTRODUCTION

Malaysia had recorded an impressive average growth rate of over 7 percent per annum since 1957 until the eve of the Asian financial crisis 1997-1998. The World Bank (1993) referred to Malaysia, along with several other East and Southeast Asian Economies, as one of the high performing economies (HPES) with full employment. And by most indicators the Malaysian economy was fundamentally strong prior to the crisis. Real gross domestic product (GDP) grew at about 8.5 percent in the first half of 1997 while the Government continued to register fiscal surpluses and, more importantly, the level of external debt was low at 43.2 percent of gross national product (GNP). Bank Negara Malaysia (1999a: 569) states that the current account deficit was reduced to 5 percent of GNP in 1996 from 10 percent in 1995 and was expected to improve further. Inflation reached its lowest level, 2.1 percent, in July 1997. Measures were also taken to slow down the pace of bank lending so as to make domestic demand more compatible with the level of output, and to contain the development of any asset bubble.

However, despite its relatively sound economic fundamentals, Malaysia was not spared from the crisis. The contagion effect spread to Malaysia soon after the sharp depreciation of the Thai baht as herd behaviour caused market participants to view Malaysia as having the same - problems as those faced by her neighbours. By the end of August 1998, the speculative attack on the ringgit had caused it to be depreciated by 40 percent against the United States dollar compared to its level at the end of June 1997. The Kuala Lumpur Stock Exchange (now known as Bursa Malaysia) Composite Index (KLSE CI) fell by 79.3 percent from a high of 1271.57 points in February 1997 to a low of 262.70 points on 1 September 1998 (Ragayah 2003). The effects were then transmitted to the banking and corporate sector, resulting in the economy experiencing a recession for the first time in 13 years by the second quarter of 1998.

The crisis demonstrated the need for better corporate practices. It hastened the calls by the International Monetary Fund (IMF) and the World Bank to raise corporate governance (CG) standards in firms and organisations. (In this study firm(s), corporation(s) & business organization(s) are used interchangeably to mean a business entity or enterprise). Although in the past arguments on the need to build stability in capital and currency markets were convincing (Rasiah 1998; Stiglitz 1998; Chang 1998; Singh 1999; and Rasiah 2000), the gross failure of a number of businesses in the wave of the crisis attracted considerable research on CG as it would reflect to a certain extent the managerial competencies of the managers involved. Thus, there is a need to better understand and analyse in greater detail the issue of corporate governance insofar as it affects the

corporate sector. As such, the objective of this article is to introduce the subject of Corporate Governance (CG) with some insights on the trends and development of corporate governance in Malaysia since the 1997-1998 financial crisis.

CORPORATE GOVERNANCE: THEORY, TRENDS AND PRACTICES

Generally, effective CG would reflect a number of important features. First, it promotes the efficient use of resources both within the firm and the larger economy. Second, it assists firms (and economies) to attract low-cost investment capital by improving both domestic and international investor confidence. Under circumstances of good CG practices, corporate assets will be used as agreed regardless whether that investment is in the form of debt or equity. Jensen and Meckling (1976) argued that rules and procedures are needed to protect the providers of capital. In this respect, business firms must comply with laws, regulations and expectations of societies in which they operate.

The Cadbury Code (1992) has defined CG as the system by which companies are directed and controlled. The OECD Principles of CG described it as a set of relationship between a company's management, its board, shareholders and other stakeholders. It provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. It should provide proper incentives for the board and management to pursue objectives that are in the interests of the company, shareholders and society as a whole, and should facilitate effective monitoring; thereby encouraging firms to use resources more efficiently. In Malaysia, the High Level Finance Committee on CG defined it 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 realizing long-term shareholder value whilst taking into account the interests of stakeholders'. Shleifer and Vishny (1997) explained that CG deals with ways in which suppliers of finance to corporations assure themselves of getting a return of some profits and to ensure that managers do not steal the capital they supply or invest in bad projects. It is also a means by which suppliers of finance control managers.

It has been contended that CG practices is not a standard mode (not a "one size fits all") and thus cannot operates in any standard form but rather vary across nations and firms (OECD 2000). This variety reflects distinct societal values, different ownership structures, business circumstances, and competitive conditions strength and enforceability of contracts. The political standing of the shareholders and debt holders, and the development as well as the enforcement capacity of the legal system is all crucial to effective CG (Gregory & Simms 1999).

CORPORATE GOVERNANCE PARTICIPANTS

In order to provide a better understanding of corporate governance practices, it is important that we understand who are the parties involved. The diagram below illustrates the various participants involved:

One can deduce from the diagram that CG is a factor in the formation of business activities. The core issue is ownership. Next is the agency problem where and if owners do not directly manage the business themselves, they would have to elect agents, known as the directors, to represent them. For CG to be effective, all the various parties, including the employees, regulators, financiers, creditors, and all other stakeholders involved have to discharge their roles and responsibilities diligently with effectiveness and efficiency. This is where the issues of accountabilities, responsibilities, transparencies and fairness must be upheld.

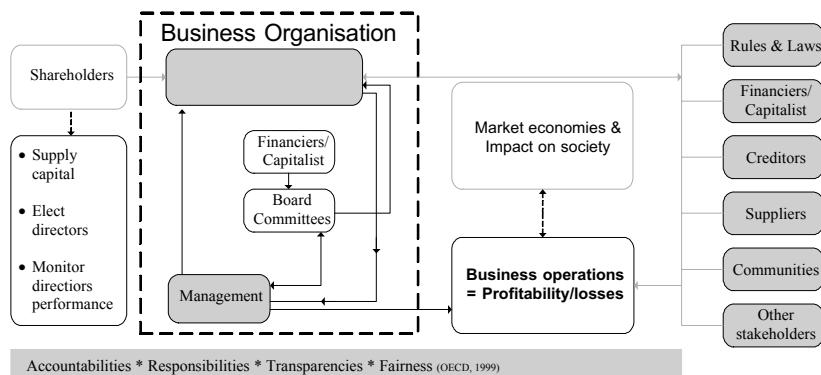


FIGURE 1. Corporate Governance participants

TRENDS AND CHALLENGES

CG is a worldwide issue involving all organised business activities. The Enron debacle of 2001 and the WorldCom and Parmalat accounting frauds of 2002 clearly testify that existing CG practices are far from being perfect even in the advanced economies. These developments brought to fore CG as an issue of enormous practical importance. More importantly, it calls for sound leadership capabilities with strong ethical principles. The trends in United States and the United Kingdom tend to have ownership spread among many shareholders, which is known as the *outsider model* (Anglo-Saxon). On the other hand, concentrated shareholdings are common in Japan and Continental Europe and is known as the *insider model*, which is reflected by the prevalence of closer control of management by owners and the discipline is provided by banks and

large shareholders rather than open markets (Dunlop 1999). The priority of the outsider model is to serve shareholder interests while that of the insider model view their responsibilities more broadly, with the stakeholder interests assuming equal if not greater importance than the shareholder interests.

Although similar to an insider model, Japanese CG characteristics have a culture of its own. CG issues, according to Sheridan and Kendall (1992) are discussed behind the scenes between the senior corporate officials and major institutional shareholders who hold substantial shares. *Kairetsu* or groupings of cross-holdings are prevalent. Issues are resolved very quietly within the confine of insiders based primarily on consensus where publicity is avoided. Thus, there are rarely any lawsuits as compared to the United States and other advanced economies. Where allocation of productive resources is concerned, they pursue a 'retain and reallocate' strategy, retaining corporate revenues and reallocating the labour force in contrast with the U.S. 'downsize and distribute' corporate policy. The common traditional cross-shareholding and lifetime employment thus become the institutional foundation that has impact on the allocation decisions. These characteristics reveals a special feature in that the participants are willing to be stable 'shareholders' and willing to forgo capital gains (Lazonick 1998). A firm would not sell its stocks to another company except under conditions of financial stress. Even if it is forced to sell, it will be sold to another stable shareholder and is expected to repurchase the stock when it regains its financial strength. The stable shareholders forgo control rights and routinely give their proxy votes to the top managers of the companies, and are willing to accept low dividend yields. Such practices resulted in a system of cross holding whereby the Japanese business community protects the power of corporate managers to control the allocation of the resources and returns of their companies.

The boards of directors of Japanese companies are usually made up of top managers, lifetime company employees, employees of other corporations who are stockholders of the company or with which the company has extensive relations. This includes banks or government agency employees who have been permanently transferred to the company. Nonaka and Takeuchi (1995) asserted that within the management structure a process of consensus decision-making generally makes key allocation decisions. In such a scenario, the top managers (directors) ultimately make the decisions but they are integrated into a process that makes them aware of the capabilities and expectations of those responsible for implementation. Nakamura (1997) highlighted the fact that there is an integration that extends downward in the hierarchy to enterprise unions and the joint consultation committees (JCCs) that involves both the labour and the management. In such a situation, the union officials who are employees confer with the management concerning various matters such as remuneration, work conditions, transfers (interdepartmental and inter-company), and production, but have no explicit rights to engage in executive or supervisory institutions of

CG. The apparent lack of ‘corporate monitoring’ is however a concern, which needs the backing of shareholder power to be effective (Latham 1999). In companies with low levels of management cross holding, corporate monitoring can be implemented by the shareholders but for those matured and huge firms with high levels of cross holding, government pressure is needed to enable owners exercise their property rights.

Singapore has a relatively thin capital market with over three hundred listed companies as at March 1999 on the Singapore Stock Exchange. Its equity is tightly held by individuals, corporations, financial institutions and the government, reflecting a CG system that is loosely based on the Anglo-American model (Li 1994; Prowse 1998). In this market, takeovers, if any, tend to be friendly rather than hostile (Phan & Mak 1999). Although by end 2002, the number of companies has increased to 501 with a market capitalisation of S\$291.27 billion (see Singapore Stock Exchange website <http://info.sgx.com>) comprising both local and foreign companies, the ownership structure of local companies have not changed much. The presence of significant high ownership concentration in the Singapore market among company management and large shareholders potentially violates the principle of the decision management and decision ratification as advocated by Fama and Jensen (1983). This principle involves the separation of the role of management (decision agents) from that of the shareholders (the residual claimants via the board of directors). The former will carry out planning and implementation processes, which is known as ‘decision management’ while leaving the board to carry out the control management via the ratification and monitoring processes known as ‘decision control’. This kind of scenario may result in the expropriation of wealth from minority shareholders to large shareholders. However, a CG survey by Pricewaterhouse Coopers in 1997 (PwC 1997) rated Singapore to be better than Taiwan, Malaysia, Hong Kong, and Japan, but lags behind Australia, UK and US. A later survey (PwC 2000) of institutional investors ranked Singapore as second only to Australia among the principal markets in the region, covering such areas as auditing, compliance, accountability, disclosure and transparency and board processes. Prior to the 1997-1998 crisis, its philosophy of regulation was predominantly merit-based, where the regulator decides whether transactions should be allowed to proceed based on their perceived merits and whether adequate disclosure has been made before the release of the disclosure is allowed. Such merit-based practices include strict rules being set to restrict the transactions that the company may undertake. In late 1997, the Monetary Authority of Singapore (MAS) via its Financial Sector Review group undertook a fundamental review of its policies in regulating and developing the country’s financial sector. The group comprising various committees such as Banking Disclosure (CBD), the Corporate Finance Committee (CFC), and the Stock Exchange of Singapore Review Committee (SESRC) made recommendations on various aspects relating to the financial sector. This review

saw two notable developments—improvements in banking disclosures and the move from the merit-based philosophy to a disclosure-based philosophy on market regulation. Since the fundamental CG practices in Singapore are reflective of an *insider model*, a key area of concern associated with it is that of the independence of its directors (Mak 2001). This point of argument is centred on the fact that new directors are typically nominated or proposed by existing directors, who are usually shareholders or who are closely affiliated with controlling shareholders.

In assessing the two models, it is found that both have their merits and demerits associated with CG practices, with each aiming to balance the negative effects of their predominant structures and control mechanisms. Thus, the argument put forth by OECD that a ‘one size fits all’ concept is not acceptable has its relevance. CG practices and structures are therefore needed in different form and in different circumstances taking into cognizance of the needs of nationality of the firm as well as the national regulatory framework. In all practicality, it should be left to the policymakers to build the necessary institutions and to design and redesign the necessary institutional features of governance. OECD (1999) outlined five key principles on CG that are focused primarily on listed entities, but where appropriate, are also applicable and useful for other categories of firms or enterprises. The five key OECD principles are rights of shareholders, equitable treatment of shareholders, and the role of shareholders, disclosure and transparency, and the responsibilities of the board. Due attention must also be given to those key CG features recommended by the Institutional Shareholders’ Committee (ISC) on the separation of the roles of the Chief Executive Officers and the Chairmen (IOD 1991). CG therefore can be also viewed as a reflection of the interplay between the various parties such as the board of directors, management, shareholders, and other stakeholders.

Given the growing concern in corporate governance the Malaysian Government realises that sanctions are required if good CG is to be taken seriously. To this end, the regulatory framework under the purview of the Securities Commission has been continuously reviewed and updated and various initiatives have been undertaken to improve CG in this country. The key changes are the move to a disclosure-based regulation (DBR) regime and the strengthening of accounting standards through the establishment of the Malaysian Accounting Standards Board (MASB). The initiatives to enhance CG also include a review of the Take-Over Code (TOC) via its amendment in 1999 and the strengthening of various laws involving insider trading, substantial shareholding as well as the conflict of interest laws. The rule on directorship was revised to limit it to ten listed companies and fifteen unlisted companies.

The Malaysian Code on Corporate Governance (MCCG), which was introduced in March 2001, laid down the new best practice guidelines. The Code had put risk management, control and internal audit functions as the focal

point of attention for corporate directors. MCCG lays down six very pertinent and specific responsibilities as best practices for directors to aid their stewardship responsibilities. Among these are the review and adoption of the company's strategic plan, oversee the conduct of the business and evaluate whether the business is being properly managed. Directors have to identify the principle risk and ensure the implementation of systems for the appropriate management. It is also the duty of the directors to ensure that there is in place succession planning for key personnel of the company as well as to develop and implement an investor relations programme including a shareholder communication policy. Lastly, the directors must review the integrity of the company's internal control system such as areas involving auditing, inspection and supervision of the business operation and management information system where it involves IT and the like. It also strongly advocated that corporate entities revamp their boards to accommodate effective structures via the formation of key board-level committees. Among those proposed as critically essential are the audit (existing), remuneration, and nominating committees. The call extends to include other committees deemed necessary based on the need of the individual firm, depending on the type of industry they are in and the type of specific-knowledge they would need at the committee level. Much emphasis has been placed on the appointment of the independent non-executive directors (NEDI), which as a rule of thumb should constitute at least one third of the board.

The introduction of the Practice Notes issued by BM since 2001 reflects a positive development for the strengthening of market practices for good governance. Further, the introduction of compulsory Companies Commission of Malaysia (CCM) Corporate Director Training Programmes (CDTP) on 21 January 2002 is certainly a very positive move. It is aimed at equipping the company directors with the knowledge of their duties and responsibilities as well as providing them with a basic understanding of the statutory laws and regulations and to highlight common areas of non-compliance and their respective punishment. The board of directors should take the initiatives to continue upgrading their skills and knowledge in this respect and the endeavour promoted by CCM on directors' training should be supported and actively encouraged.

THE THEORY OF OWNERSHIP AND AGENCY PROBLEM

Ownership and control constitute separate factors of production as the management makes decisions while the owners bear the residual risk of profit or loss. The linkage between the owners and the directors then are crucial in highlighting the way in which the assets and resources are made available and controlled. Managing and controlling such resources made available by the owners is the main issue in CG. Ownership is having the legal right over the use, disposal and fruits of the means of production in society (Lim 1981). Thus, in

the corporate sense, to have control over a corporation is to have the capacity to determine the policies and course of action of that corporation. Likewise, control is defined as a relation to power—the capacity to initiate, constraint, circumscribe, or terminate action, either directly or by influence exercised on those with immediate decision-making authority (Herman 1981). Since the board of directors is elected by the owners, it is inevitable that the ownership structure will dictate the control of the business organisation (Leighton & Thain 1997). This relationship has significant impact on the corporate practices as well as the performance of the business.

A business firm with many disperse shareholdings with many shareholders scattered in different locations would not be able to manage the firm themselves. In many instances most of them have a minor shareholdings and do not have a say in the running of the business. There are also others who may not be interested in the management of the firm. Under such circumstances, they have directors who are elected by the shareholders to act on their behalf as legal trustees to manage the firm. These directors are known as the agent of the shareholders and there are many instances where agency problems may arise.

OWNERSHIP AND CONTROL

The literature on ownership and its evolution became prominent and had attracted much attention since the publication of the classic *The Modern Corporation and Private Property* by Berle and Means (1932). It explains that with the growth of the firm came an increasing need for capital to engage in production along with market development and evolution. Given the increasing demand for capital and with the limited ability for the owner-manager to supply all the monetary requirements, it means that capital will have to be accumulated from an increasingly larger number of individual investors, resulting in dispersion in the concentration of ownership. This means that owners are less able to coordinate themselves in order to monitor the actions of management while the relative power of the managers to control the wealth of the corporations' increases, making them *de facto* owners (Demsetz 1983). The CG issue here is how these dispersed shareholders ensure that managers look after their interests.

The institution of ownership accompanied by secure property rights are the most common and effective way in providing incentives to create, maintain and improve assets. In the absence of such rights, there are no incentives and the accumulation of capital will not take place thereby retarding economic growth and development. The creation of incentives and attachment of value to ownership is akin to the argument that people would take better care of their own house than they would a rented house. Similarly, it is argued that employees would tend to work harder and use more ingenuity in their job functions if they have an ultimate share in the profits of the business they are working for. Milgrom

and Roberts (1992) explained that in economic terms, the concept of ownership has been concentrated along two main issues, one on *residual control* and the other on *residual returns*. This implies that a person who owns something has certain rights and obligations concerning its use. In the economic sense, it means that owning an asset is having the residual rights of control, which is the right to make any decisions concerning the asset's use that are not explicitly controlled by law or assigned to another by contract. In the case of residual returns, it means more than just control rights as it effectively allows the owner to refuse the use of an asset by anyone who will not pay the price demanded by the owner making them the residue claimant. Thus, the combination of these two elements (residual returns and residual control) forms the key incentive effects of ownership. These are critically important as the decision-makers bear the full financial impact of their choices.

OWNERSHIP STRUCTURE

The next important element of ownership is its structure. The structure influences as well as detects the organisation's direction and performance, which has serious implication on the CG system. Ownership concentration and composition are the two key aspects of the ownership structure. Schleifer and Vishney (1997) found that ownership concentration in a firm determines the distribution of power between its managers and shareholders. They contended that when control rights are concentrated in the hands of a small number of investors with a collectively large cash flow stake, concerted action by investors is much easier than when control rights are split among them. Literally, when ownership is dispersed, shareholder control tends to be weak because of poor shareholder monitoring. This in part could be attributed to the so-called free rider problem where a shareholder with a small stake would not be interested in monitoring as he or she would have to bear all the monitoring costs where in fact only a small proportion of the benefit will accrue to him or her.

In a concentrated ownership situation, large shareholders are expected to play a key role in monitoring management. However, corporate management is usually in the hands of the controlling shareholders; this is in part due to the lack of interests in certain cases where large shareholders (institutional investors) are passive and interested only in profit. One key CG issue then is how to protect minority shareholders from the expropriation by controlling shareholders as the latter might act in their own interests at the expense of the minority shareholders and investors. Some of these activities could be in the form of paying themselves special dividends, committing the company into disadvantageous business relationship with other companies they control, and taking on excessively risky projects inasmuch as they share in the upside while the other investors (who might be creditors) bear the cost of failures.

OWNERSHIP COMPOSITIONS

The composition of ownership structure, who they are and who among them belongs to the controlling group(s), is another significant factor insofar as CG is concerned. Zhuang et al. (2000) contended that a family or family group who are significant shareholders would be more likely to be interested in control benefits as well as profits. On the other hand, an institutional investor who is a significant shareholder is more likely to be interested only in reaping profits. These differing interests raise the concern that apart from being the 'capitalist' of the business organisation, it becomes questionable whether the equity owners (shareholders) are playing their role. Lim (1981) showed that concentration of ownership affects potential control in that it enables the large shareholders to command more control than the actual amount of stocks they actually own, while control capability of small stockholders is minimised. Thus, concentration of ownership becomes one of the key factors affecting CG in any economy.

Zhuang et al. (2000) found the ownership pattern in Malaysia has changed little over time and that the majority of the shareholdings by the nominee companies and institutions (non-financial and finance companies) were owned by families. Their study found that since 1997, nominee companies held 45.6 percent of the total shares of an average non-financial Public Listed Company (PLC) held by the top five shareholders. Non-financial companies (25.1 percent), the government (17.2 percent), finance companies (5.9 percent), individuals (4.8 percent) and foreign investors (1.5 percent) shared the rest. The high percentage of such institutional holdings has been attributed to the government's efforts to reallocate corporate shares to indigenous Malaysians and the countervailing efforts of non-indigenous Malaysians to maintain their ownership. Thus, shareholders opted for nominees as a means of not revealing the identities of the true holders. Equally, there are a number of mechanisms that are used to strengthen the ownership and control of corporations. The two most common and important modes is that of interlocking stock ownership and interlocking directorates (Lim, 1981). A case in point as highlighted in the press is that of a PLC on the main board of BM. It reveals a situation where prior to the exit of its Chief Executive in June 1999, interlocking ownership and interlocking directorates enabled him to stay in control without having any personal shares in the said PLC (see *The Edge*, July 9-15 Issue No. 352).

The implication of concentrated ownership structure is that the owners have nearly absolute control (Lim 1981; Leighton & Thain 1997). This implies that the degree of ownership concentration in a company determines the distribution of power between its managers and shareholders such that when control rights are in the hands of a smaller number of investors with collectively large cash flow stake, concerted action by investors is much easier than when control rights are split among them (Schleifer & Vishney 1997). This supports the finding of Lim (1981) that control inflates the power of big owners and

deflates the power of the small owners where under such circumstances the relationship between ownership and control is no longer linear. In such a situation, it gives rise to a fundamental problem of how to protect the minority shareholders from being expropriated by controlling shareholders. The question then is what must the board of directors as the legal representatives of the shareholders do to ensure that all shareholders are given equal treatment and that their investments are duly protected.

THE AGENCY PROBLEM

Agency problems arise when owners themselves do not manage the organisation. In most cases, they have agents acting on their behalf via the system of the board of directors. These agents, who are also known as the company directors, in turn appoint managers to manage the operational affairs of the organisation. Although managers are entrusted by the board of directors with enhancing and advancing the interests of the shareholders, it is the board of directors themselves who are empowered to make corporate decisions, decide on the executives' compensations, as well as supervise these managers. These two levels of organisational personnel, both with the responsibilities to enhance and value-add to the interests of the firms, are in effect agents of the shareholders in a situation when there is separation of ownership and control of the firms. Thus, when managers or board members do not pursue activities that enhance or value-add to the interests of the shareholders, the issue of moral hazard comes into play (Milgrom & Roberts 1992). The agency problems then are essentially viewed as conflicts of interest between equity and debt holders and between managers and shareholders, and these have been considered as the main corporate governance issues. Debt contract provides that if an investment gets returns well above the face value of the debt, equity holders capture most of the gain. However, in a situation where the investment fails, the debt-holders bear the consequences since equity-holders of corporations have limited liabilities. This led to a situation where equity-holders would be inclined to invest in very risky projects by borrowing as they tend to benefit more from such investment (Zhuang et al. 2000).

One significant agency problem from the perspective of CG is the conflict between shareholders and managers whereby managers would invest less effort in managing the firm or transferring firm resources to their own outfits. This may also include managers maximising their own salary, bonuses and benefits at the expense of the firm (Ritter, Silber & Udell 1997). Thus, the separation of ownership and control involves moral hazard insofar as those managers in control (the agents) may act in their own interest rather than in the interest of the stockholders-owners (the principals), primarily due to the fact that managers have less incentive to maximise profits than the stockholders. As such, the issue

of monitoring the management by the board and the board by the shareholders is crucially important. Eisendhardt (1989) argued that a standard agency relationship may help alleviate some of the problems, and that such a relationship is governed by contracts that should specify the terms of performance and duties of the contracting party, which in some cases may include specifying the processes to be undertaken to procure the desired results. However, in most cases managers have the skills and knowledge not possessed by the shareholders, and because of these limitations in terms of skills and knowledge on the part of the shareholders, the contracts entered into may be under-specified in terms of the performance standards. Further, monitoring would be a problem because the shareholder would not be able to observe everything that the manager does (Phan 2000). Moreover, even if the problem is detected, solving it would be difficult given the fact that coordinating the actions of all the shareholders that are dispersed would be time consuming and very costly (Demsetz & Lehn 1985).

MECHANISMS TO ADDRESS THE AGENCY PROBLEM

The agency problem essentially relates to how shareholders effectively monitor managers and exercise control to ensure that their interests are protected. Thus, to address CG issues is basically to address the agency problem. Malaysia, like any other countries around the world faces the same issue and similarly has to address the same problem.

The approaches to deal with agency problem can be grouped into two broad categories of possible solutions and are inter-dependent on each other. As argued by Vance (1983), Louden (1982), Phan (2000) and numerous other CG proponents, the owners via the board of directors, known as the internal control mechanism, is the first category of such solution. The second category is that of external control mechanisms that monitors and disciplines the management. These market-based mechanisms involve a host of market elements such as competitions, market for managerial talents and compensations, and the market for corporate control. Equally, there is a need to ensure that there are adequate rules for transparency and information disclosure, and adequate rules to ensure the rights and equitable treatment of shareholders, in particular the minority shareholders. These owners owe themselves a responsibility and should ensure that there is shareholder activism in order to protect their investments (Minow 1995). This is evidenced by the fact that monitoring done by CalPERS on under-performing companies in which they had invested resulted in \$137 million in extraordinary gains.

INTERNAL MECHANISM: OWNERS AND BOARD OF DIRECTORS

The agents of the owners are legally recognised as the directors of the company. These directors organised themselves in a platform or body commonly known as the corporate board. Board formation is necessary because a company by

itself is an inanimate entity and has no physical existence and can only act through its agents, the directors (Goh 2000). Vance (1968) defined the corporate board as the top echelon of the corporation, the ‘controlling mind’ of the corporation, and the ‘conscience’ of the corporation. The board of directors as the legal trustee must work as a team in discharging their legislative and managerial responsibilities even though individuals may be entrusted with specific responsibilities or assignments (Louden 1982). Demb and Neubauer (1992) put it simply that the board’s role is making judgment and making choices. The board must also constantly be challenging the management to see both elements of the bigger picture, meaning that the management must act and think beyond what they are presently doing and need to look at new ideas and ways of doing things for the betterment of the organisation. There is also a need to create a constructive tension that can lead management to a more robust response to the fundamental demands of corporate governance. The board then is deemed as the key CG mechanism as its members represent the shareholders, particularly in the case of large public companies with dispersed ownership of shares. Directors must organise themselves, formulate and device the structure, processes and practices of the firm to enable it to achieve its desired goals (Anandarajah 2001). In the context of CG, accountability is what makes delegated authority legitimate; without accountability, there is nothing to prevent abuse (Monks & Minow 1991). The board of directors is being viewed differently from the other groups that have dealings with the corporation such as customers, suppliers, lenders, and labour because the shareholders they represent do not have contractual protection of their interests (TIAA-CREF 2000). Thus, board members (directors) have responsibilities and must be accountable to the shareholders, the firm and other stakeholders. In a nutshell, the power to protect shareholders’ rights and interests, reward and punish managers and direct the affairs of an organization lies with the board reflecting its importance as the key CG mechanism.

EXTERNAL MECHANISMS

There are three main categories of external control mechanisms that can address the agency problem (Zhuang et al. 2000). These are competitive market conditions, the market for managerial labour and talent, and the market for corporate control. Each of the three mechanisms would indirectly affect the behaviour of managers and punish the company for deviating from the efficiency maximization objective.

1. *Competitive market conditions*

Market competition means that managers must act in an efficient manner failing which they will be forced out of the market. This indirectly provides protection for the shareholders and creditors. Effective and capable managers will have a

better chance of survival (Phan 2000). It is therefore important that the management team is efficient and able to make good choices and understands the market well. Otherwise, resources would be misallocated through the introduction of wrong products or selling at the wrong price. Such poor decision-making would result in a declining shareholder value as well as poor financial performance for the firm. In CG practices, these signals and other relevant information must be translated into investment decisions that will ensure the survival of the business whether the decisions are correct or otherwise (Berglof 1997). It is inevitable that such decisions may involve replacing management for poor performance or closing down unprofitable units. Such actions are deemed crucial to the argument that competition and CG are seen as substitutes with strong CG being more important when competition is weak.

2. Managerial Talents and Compensations

The top executives are responsible for their own employability as well as their pay since their opportunities for employment are limited. This is where their performances as effective and efficient managers are crucial for their own survival (Daily & Schwenk 1996). Owners, via the board of directors, ought to be concerned about how they pay and reward their managers in view of the separation of ownership from control. In preparing an ‘acceptable’ incentive package, the specific details of the agency problem, such as aligning the interests of the managers and the shareholders, must be considered. In practice, generally such remuneration packages often involve performance-related pay and the award of stock options to managers. However, Jensen and Murphy (1990) found that there is little evidence of a strong link between this type of contract and corporate performance. In good CG practices, the shareholders or agents *acting independently* on behalf of shareholders should determine the executive remuneration. This implies that independent non-executive directors who represent all shareholders must decide on the top-level executive remuneration so as to avoid conflict of interest.

In Malaysia, Zhuang et al. (2000) found that most of the chairmen and the chief executive officers (CEOs) draw fixed salaries. In recent times, the trend is moving towards companies paying their CEOs a fixed salary plus a performance-related pay including stock options with the CEOs proposing the remuneration packages for approval by the boards. Alternatively, the chairman or the executive committee (if there is such a committee) propose them resulting in decision-makers in these two categories tending to scratch each other’s back. In CG, the key concern that arises is whether there is any independent assessment of the remuneration packages that are approved and whether the beneficiaries deserve such packages. Thus, in line with good CG practices, it ought to be an effective independent board level “compensation committee or remuneration committee” that should peg the remuneration packages accordingly to maximise its intended benefits from the performance of the beneficiaries.

3. *Market for Corporate Control*

The market for corporate control is a market in which the investor or management teams buy and sell corporations and compete for control of a company. In a nutshell, the market for corporate control is a corporate takeover market in which mergers, acquisitions, hostile takeovers, leverage buy-outs (LBOs), and management buyouts (MBOS) take place. A broader definition includes a variety of other organizational restructuring events that are related to attempts by one team or another to retain or get control of the company. These events include divestitures, spin-offs, and initial public offerings (IPOS).

In terms of corporate control the Malaysian scenario reflects a pervasive presence of interlocking ownership (Lim 1981) as well as the presence of government investment vehicles. This situation has not changed much in recent years. The tight control by the Securities Commission of Malaysia (SC) and the Code on Takeovers and Mergers imposes a severe constraint on the market for corporate control (Thillainathan 1999). Moreover, Chandrasegar (1995) argued that the Asian cultural attitude towards business is marked by an avoidance of aggression and confrontation, which thus precludes the use of tender offers. Such culture bias suggests that the aggressive and flamboyant corporate raider's approach of the Anglo-Saxon world is rarely present in the Malaysian market. Thus, the discipline of a takeover market on director behaviour (Jensen & Ruback 1983) is considered to be weak in Malaysia.

Some key corporate developments that occurred in 2001 possibly signalled the changing scenario of corporate market practices taking place in Malaysia. The UEM-Renong saga, deemed as a gigantic corporate failure in Malaysia that involved the indirect intervention by the government through its agencies to restructure the group is being dubbed as a 'cleaning up' exercise by the government. The UEM-Renong group, one of the most highly indebted groups (estimated at RM24 billion then), saw the government taking over control by removing the person in charge then from the group. This clearly showed that the government is serious about ensuring that there is transparency and corporate governance in the market place. The take-over of Malaysian Airline System (MAS) in the same year represents a similar endeavour by the government in cleaning up corporate Malaysia. The wrestling for control of Palmco by the Sime Darby group from IOI Corp Berhad in the last quarter of 2001 evidences the emergence of the market for corporate control. The tussle for control of Palmco was one not due to the mismanagement or under-maximizing of shareholder value on the part of IOI. It was rather a bid by Sime Darby to acquire an asset that could have synergy and add value to its own core business activities, which is oil palm plantation. Similarly, the take-over of TRI by Telekom in the early part of 2002 presents an equally interesting episode in the Malaysia equity market given that it actually reflects a tussle of control for ownership over a sizeable and valuable corporate entity. Essentially, it is one that is more for

enhancement of synergy and value adding to their existing business, while at the same time ‘taking out’ of managers who have not managed the assets well.

Since then, the market has been relatively quiet in this respect until the CIMB Group bid for the control of the Southern Bank Group in 2006. The acquisition by CIMB was more for the enhancement of synergy and adds value to their existing business. The two entities, which are controlled by Commerce Holdings Berhad, have since being merged under the CIMB brand.

The preceding discussion has to a certain extent helped to explain the agency problem in Malaysia. The board of directors, known as the internal control mechanism, has been highlighted as the key CG mechanism. Other requirements needed to facilitate good CG practices would include the existence of a satisfactory legal framework and enforcement machinery, and equally, a need to have in place a good set of disclosure rules and an efficient market infrastructure. In addition, the existence of a well-developed market and the presence of healthy shareholder activism are needed to facilitate the control of corporate assets.

CORPORATE TRANSPARENCY, ETHICS AND SOCIAL RESPONSIBILITIES

The call for more transparent financial reporting and evidence of better ethical conduct has gotten greater than before. These are viewed as essential requirements in restoring the public’s confidence in corporate practices. Business ethics should involve corporate social responsibility, which means that corporations should be responsible and are held accountable for any of its actions that affect people, their communities and the environment. Social responsibility of corporation is the recognition that organizations have significant influence on the social system and that this influence must be properly considered and balanced in all organizational actions (Newstrom & Davis 1993).

CORPORATE TRANSPARENCY

Reliable and timely information on the company’s financial results, major share ownership, directors and their remuneration, and key executives are some of the requisite information deemed critically essential for good transparency (APEC 1998). These are all called for under Bursa Malaysia Listing Requirements (BMLR), SC guidelines and under the MCGC that was introduced in March 2001. Other pertinent and essential information needed for proper dissemination to shareholders and investors alike are the governance structures, company objectives and policies. These elements are also keys for such disclosures and transparency to take place. For this aspect (transparency) of CG to be effective, it involves the effective process of disclosures and auditing.

Moreover, Thillainathan (1999) and Ang et al. (2000) argued that such practices are needed to ensure effective shareholder control and protection. To value add to the information released, it is important that the release must be accompanied by statements relating to pertinent foreseeable risk factors, governance structures and company objectives and policies. When these practices are executed properly, they would result in a management that acts in line with the objective of maximising shareholder's wealth as Baker et. al (1977) claimed that individual investors tend to highly value accurate disclosure of information and are prepared to pay a premium for their investments in such companies. Similarly, Anderson and Epstein (1995) found that individual investors would like to have access to more additional disclosure in annual reports in terms of both quality and quantity. It can thus be concluded that investors tend to have more confidence in companies that provide quality disclosure of information in a transparent manner.

The assurance of quality disclosure and transparency is dependent on the accounting and auditing standards and the financial reporting system in practice (Nam et al. 1999). In supporting this view, Narayanaswamy (1999) further argued that the accounting must meet international standards and auditors must not only be independent of the influence of the business whose financial statements they audit, but they must also be technically competent. Particularly, the auditors' work or examination must be fair and impartial. Bhattacharyya (1999) asserted that this assurance can be achieved under the direction of the board of directors via its audit committee with clearly specified terms of reference to enhance the independence of statutory auditors (external auditors) as well as the accounting and internal auditing functions of the company. However, he also pointed out that the auditors' independence can be lost if they develop too close a relationship with management, against which the board must jealously guard. Audit committees are therefore crucial to the standards exhibited by the auditors, ensuring adequate internal control mechanisms, and focusing on reviewing financial risks and management risks. When these are effectively carried out, the directors will be fulfilling their fiduciary duties to the shareholders, creditors and other stakeholders.

CORPORATE TRANSPARENCY TREND IN MALAYSIA

In 1996, the SC decided that a shift to a disclosure-based regulation (DBR) is a necessary progression for the Malaysian capital market to become more efficient and to be a credible market of international standing. The three tenets of DBR are Disclosure, Due Diligence and Corporate Governance. Under the DBR based regime, it is the responsibility of the directors of public listed companies to ensure that all material information required by the public in order to make investment decisions is provided accurately, in full and on a timely basis. Prior to 1996, Malaysia had in place a merit-based regulatory regime in deciding on

the suitability of a company for listing and the pricing of new issues, which was usually based on the need to protect the interest of minority shareholders. The introduction of DBR-oriented approaches implies that firms are required to disclose all material information at the time of new listings, as well as on a periodic or continuing basis thereafter depending on the type of information to be disclosed.

In order to enhance market incentives, BM has instituted regulations that call for timely disclosure of material financial and corporate information from the listed companies. In terms of disclosure policies, the BM-PwC survey in 1998 revealed that most companies (80 percent) had already established formal policies and procedures to monitor the degree of compliance with the requirements. Zhuang et al. (2000) pointed out that Malaysia scored relatively high, even by international standards, for the general quality of its auditing and financial reporting. This can be attributed to the fact that it adopted accounting standards that are consistent with those issued by the International Accounting Standards Committee (IASC) since the 1970s (Thillainathan 1999). In 1997, the Malaysian government established the Malaysian Accounting Standards Board (MASB) under the Financial Reporting Act 1997 (FRA) as the sole authority to set up and enhance the accounting standards in the country. Its aim is to keep pace with the international accounting practices, including among others, to lay the foundation for a more efficient financial reporting regime in the country.

Recognising the importance of auditing, BM had since 1994 made it a mandatory listing requirement for public listed companies to set up an audit committee. Such an internal control mechanism, which is an extension of the board structure, has been actively promoted as one of the key CG governance structure for the well being of the any business organization. The MCGC introduced in March 2001, has prescribed with explicit details the committee's role, rights, composition and functions with specific focus on accountability and the audit process. Likewise, a similar prescription is provided for under the Revamped Listing Requirements (RLR) issued by BM. The Malaysian Companies Act (CA) 1965 imposes various duties on auditors (statutory) to review and highlight errors and discrepancies in company accounts. Essentially, the main objective of an audit is first, to certify the correctness of the financial position as shown in the balance sheet and the accompanying revenue statements; second, is to detect errors, and third, to detect fraud (Anandarajah 2001). External auditors, who are also a mandatory requirement, have a big role to play in ensuring that CG practices are adopted. The auditor's position is unique since, although he is not an officer of the company, he is placed in a position to review the documents and financial data in the company. This uniqueness enables the auditor to uncover any misfeasance and fraudulent acts initiated in a company after careful examination or study of the financial records or reports of the company. More importantly, the auditors are supposedly to be acting 'without

favour or fear' or independently as they are not reporting to any of the managerial members of the company except to the board of directors via the audit committee.

CORPORATE ETHICS

Ethics deal with what are right and wrong, and the moral implications that result from the decisions being made. Ethics, however, represents more than just the need for compliance with the law as the latter fails to provide any effective control over the conduct of business behaviour. This is because laws are often the result of demands made by the public following the occurrence of an unfavourable situation. Chryassides and Kaler (1993) argued that a pure static code or a set of principles that used to be understood and agreed upon can no longer exists in today's business environment. Such a change is attributed to the dynamic, fast paced and ever changing times, where both the underlying purpose and the rules of the business game are becoming ever increasingly unclear. In essence, ethics is concerned with clarifying what constitutes human welfare and the kind of conduct necessary to promote it (Powers & Vogel 1980). The moral dimension of business that involves market participants, society at large and work environment, questions concerning profits, growth and technological advancement have ethical dimensions. Hoffman and Frederick (1995) and Shaw (1991) defined ethics as what is good or right for human beings and business ethics is a branch of applied ethics which studies the relationship of what is good and right for business. Good ethical values are an essential component of good effective leadership.

The societal nature of the business firm is such that if it is to attain its end and to realise its goals, all the people involved must cooperate. Such cooperation and unity of purpose is not automatic but rather a creation by its managers (Garrett and Klonoski 1986). Trust, cooperation, honesty and fairness compose the bedrock upon which society and the business firm rest. As articulated by Cavanagh and McGovern (1988), these virtues depend in turn upon the ethics of managers and the organisational climate they inspire. As such, without these virtues, the long-term success and growth of the firm are impossible as increases in productivity and product quality depend upon these attributes.

ETHICAL LEADERSHIP

Shaw (1991) explained that the intimacy between ethics in general and ethics as applied to business contexts implies that one's personal ethics cannot be neatly divorced from one's organisational ethics. The people in the organisation are like the blood in a human body without which there will be no life, since the firm (on its own being inanimate) is created and run by the people and that all companies begin life in the minds of individuals. Thus, it is the people in the

organisation that imbue it with a sense of mission, purpose and a view of the world, as they perceive it. In this respect, it is therefore argued that personal ethics is highly associated or intimately connected with business ethics. Andrews (1989) claimed that the future of a corporation is what its leadership and membership makes of it. Hence, the exercise of ethical leadership in the corporation is essential. In an organisation, it is the people that influence each other to establish accepted values and the ways of doing things. The board of directors as corporate decision-makers is the top echelon of the corporation, the 'controlling mind', and the 'conscience' of the corporation (Vance 1968), thus has an important role in exercising ethical leadership.

ETHICAL CORPORATION

Post, et al. (1999) stressed that corporate ethical action could be improved by creating or revising various organisational safeguards, such as code of ethics, ethics committees, and employees' ethical training. Cavanagh and McGovern (1988) explained that when managers and workers are not ethical, they focus on the short term, are self-centred and have little respect for other persons. On the other hand, an ethical corporation has an environment that is characterised by good ethics where people are able to distinguish right from wrong and are encouraged to follow their conscience. Donaldson (1996) and Phan (2000) highlighted that there are four elements to a company's ethical climate and they have to be in place before the ambiance can be created. The four elements are shared values, managerial example, appropriate performance measures and rewards and the system of recruitment and advancement used to staff the organisation. These four elements form the lenses and levers of a corporation's ethical atmosphere. It is through these elements that the ethical environment is continually being examined for internal consistency with its strategic goals and objectives, and shaped for alignment when these goals and objectives shift. Generally, shared values (the first element) pull an organisation together and managerial example (the second element) is equally important as it implies that a manager communicates his intention by the way he behaves. The organisation's reward system (the third element) is another important influencing factor for managers and should be designed to reward appropriate ethical behaviours and punish inappropriate ones (Melman 1956). This is because people tend to behave as they are rewarded. With respect to the fourth element, it is essential that the management explicitly include assessments of personal ethics in their recruitment practices. This means that the management must devise appropriate hiring and appraisal systems, and ensure that such systems have incorporated ethical value to be championed in the hiring and promotion processes. It would indeed be unhealthy just to recruit a so-called star performer without checking on his background and his mode of achievement. In this regard, while boards are ultimately responsible to shareholders for the bottom line, it would be equally

disastrous for them to ignore ethical standards in the pursuit of maximising profits. In carrying out a promotion exercise, the organisation must not only promote the best performers, but must also include those top performers who practise high ethical behaviour in getting to the top.

CORPORATE SOCIAL RESPONSIBILITIES

The business firm is also classified as a social organisation with a character and conscience. Moreover, according to Molz (1995) the business firm can only succeed when the different roles and claims of the various stakeholders of the organisation are clear and recognized. Today, social responsibility has become one of the key stakeholders of business firms that fall within the ambit of the requirement needed for practical and sound business ethics. In short, there is a need for strong corporate culture with high ethical values. In a social system, an ethical corporation is one that acknowledges that it exists and operates in a pluralistic society, where it is a complex set of human relationships interacting in many ways. Newstrom and Davis (1993) contended that within a single organisation, the social system includes all the people in it and their relationships to one another and to the outside world. Thus, when viewed from this perspective and considering that the legitimacy of its survival is dependent upon that conferred by society then it is natural that society expects the firm to contribute to its welfare in various ways. In acknowledging these societal needs, many firms today stress on the importance of good corporate citizenship and the business's responsibility to society in their code of conduct (Manley II 1991). Drucker (1979) advocated that a firm must be able to make enough money to cover the costs of the future, and views this obligation of making enough profit as the first corporate social responsibility of a business firm. According to Drucker, if this first social responsibility is not met, then no other responsibility can be met because decaying businesses in a decaying economy are unlikely to be good neighbours, good employers, or socially responsible in any way.

CHARITY AND THE STEWARDSHIP PRINCIPLES

In order to achieve a socially desirable corporate social responsibility in business firm, it must have two basic principles, the charity principle and the stewardship principle (Post et. al 1999). The charity principle stands for the idea that the wealthier members of society should be charitable toward the less fortunate, for example, for firms and their employees to unite in their efforts to extend aid to the poor and the needy. These activities could involve the establishment of pension plans, employees' stock ownership and life insurance programs, unemployment funds, limitations on working hours, and higher wages. Building of houses, churches, schools, and libraries, providing medical and legal services, and giving to charity are all part of good social responsibility. The stewardship principle stands for the position taken by corporate leaders as stewards, or

trustees, who act in the general public's interest. This implies that business leaders (not notwithstanding that their companies are privately owned) must try to make profits for the stakeholders. Based on this principle, the business leaders must believe that they have an obligation to see that everyone, particularly those in need, benefits from the company's actions. Post et al. (1999) explained that based on this view, corporate managers have been placed in a position of public trust. This is because corporate managers who have control over vast amount of resources should uphold the responsibility to use these resources in ways that are good not just for the stockholders but also for society as a whole, thus becoming stewards or trustees for the society at large. In this respect, Abrams (1951) and Eells (1960) stressed that the corporate managers are expected to act with a special degree of social responsibility in making business decisions. Corporate social responsibilities of business firms must include an awareness and mindfulness of the need of a broader perspective on a variety of issues. These include issues surrounding economic growth and efficiency, education, employment and training, civil rights and equal opportunity, medical care, pollution abatement, conservation and recreation and a host of other activities that encompass societal interests.

INVESTOR RELATIONS AND SHAREHOLDER ACTIVISM

Where firms have corporate practices that are transparent and with high ethical standards ingrained, it will attract more investor interests. As such, it is ideal that firms must be prepared to have open channel for communications with investors and minority shareholders as well as other stakeholders. In this regard, having effective investor relations is highly value adding in the CG context. Generally, shareholder activism will lead to greater transparency, democracy and responsibility in the corporate sector.

INVESTOR RELATIONS

Investor relation forms an important component of the endeavours to have an effective corporate transparency and thereby improving CG. It is an avenue or process where investors can readily access information about the company. In short, it is those activities that deal with disclosure or release of information. To be effective and relevant, investor relation must be taken seriously under the purview of the board to ensure that all relevant and up to date information is available to the stockholders and public at large. These activities are also required to support the market regulatory requirements. For public listed companies, it can include but not limited to the following:

1. Having a separate department and website dedicated to investor relations (Website to cater for corporate information, financial information, dividend

- policy and payment, shareholdings, shareholding restrictions, company news, stock information, and email access).
2. Providing the correct and timely release of information. Such information may be earnings releases, earning forecasts, annual and quarterly reports.
 3. Press releases are also part of investor relation and are the responsibility of the investor relations department.

By installing effective investor relation programme, it will facilitate investors to have easy access to the information they need in making investment decisions. It is a worldwide trend that investors are always seeking fast and reliable information of the firms that they are interested to invest in (Baker et al. 1977). In this respect, those companies that have effective investor relations will have a better chance of attracting these investors provided the companies are sound and worth investing.

SHAREHOLDER ACTIVISM

Shareholder activism is a way that shareholders can claim their power as company owners to influence a corporation's behaviour. It is a process through which shareholders can get information regarding the firm and input points of view into the firm that otherwise would not be there. It is only through shareholder activities that investors are constantly demanding for more information from companies, building on past efforts to gain greater transparency, democracy, and responsibility in the corporate sector.

The CG participants that are involved are the non-controlling shareholders (who may have large shareholdings) who have no say in the management of the firm. The fundamental reason for shareholder activism is the conflict of interest between managers and shareholders (Jensen & Meckling 1976). Controlling shareholders via the board of directors is considered an internal CG control mechanism. Shareholders activism is thus viewed as a highly important complimentary mechanism, albeit an external one. However, due to the free rider problem, Grossman and Hart (1988) and Shleifer and Vishny (1986) argued that only a large shareholder has the incentive to undertake monitoring or other costly control activities. All shareholders benefit from such activities although they do not bear the costs of the process. However, Minow (1995) maintained that owners are responsible and accountable for ensuring that there is shareholder activism in order to protect their investment, viewing it as an essential component of investment management. Moreover, shareholder activism is considered as one of the possible ways to improve corporate performance and accountability and that firms perform better when they have systems for employees' feedback that grant employees greater voice in the enterprise (Gates 1998). One possibility is for an institutional investor as a shareholder to exercise *its* ownership voice

by encouraging companies to grant employees via the share ownership scheme an opportunity to exercise *their* voice. Regan and Gibson (1991) supported employee ownership arguing that it will both closely align workers' self-interest with that of the corporation and provide the company with another source of capital. This is because when managers and workers are owners, accountability pervades the company with beneficial results. Still employee ownership raises the concern that even when the chief executive is granted stock options he might manage just short-term profits to enable himself to cash out at the earliest opportunity without regards for long-term gain.

While more active shareholder activism increases corporate accountability, they could also help improve the relationship between the corporations and the public at large. Surowiecki (1997) expounded that the more involved investors become in CG, and the more committed they become to the idea of themselves as owners rather than as short-term riders, the more respectable shareholder activism will become. Nevertheless, even though the value of shareholder activism is clear, the actual incentive for an individual investor (a minority) to act is non-existent. A choice that makes sense is for the individual investor to sell his stock if he feels that the company is going off the rails, or simply sit quietly if he thinks it is doing well. To ensure more effective corporate monitoring, both Gilson and Kraakman (1991), and Tosi et al. (1991) proposed that the directors be nominated by an independent entity, which would thus be motivated to favour shareholder interests. These would ensure that shareholders could gain effective control over their firm's management thereby resulting in giving the board and management a greater incentive to serve the owners' interests (Latham 1999). It is argued that this approach will lead to higher productivity of capital, more realistic levels of executive pay, less short-termism, and a moderation of the corporate bloat that tends to necessitate drastic cuts.

Generally, participation by minority shareholders in corporate decision-making in Malaysia is weak, as shareholders participation is rather passive. However, when compared to other countries, Malaysia has better legal protection for minority shareholders. The Malaysian CA 1965 stipulates a number of shareholders' rights, including the right to have access to regular and reliable information, to call for emergency shareholder meetings and to make proposals at shareholder meetings. It is also a requirement that companies have to disclose specified information to shareholders, such as connected interests, company affiliation, affiliated lenders or guarantees. It is also specified that shareholders be entitled to full pre-emptive rights on new stock issues unless they have voted to do otherwise.

SHAREHOLDER ACTIVISM IN MALAYSIA

The dispersed shareholdings in the Malaysian market make joint concerted shareholder activism efforts difficult. The free rider problem is also relevant to

Malaysia. However, in practice, such large shareholders are rather passive and rarely exercise their rights. Minority shareholders are handicapped to a certain extent as most of them are not aware of their rights under the CA 1965 in protecting their interests. Thus, shareholder activism in Malaysia prior to the 1997-1998 financial crisis is practically non-existent. The issues surrounding a few big entities following the 1997-1998 financial crisis certainly provides much food for thought where shareholder activism is concerned. Nevertheless, with an overall view to enhance CG, a watchdog group known as the Minority Shareholder Watchdog Group (MSWG), a non-profit organisation, was set up in August 2000 aimed at protecting the interest of minority shareholders as well as to enhance foreign investors' confidence in the local market. (*Sunday Star*, Sept. 9, 2001 & *New Straits Times*, Sept. 10, 2001). Founding members of the MSWG comprises Employees Provident Fund, Permodalan Nasional Bhd., Lembaga Tabung Haji and the Social Security Organisation. These members are active investors in the Malaysia equity markets, although in most instances they are holding non-controlling stakes in the companies that they have invested in. In any case, their intended active participation via the MSWG would indeed be meaningful given the influence they would be able to assert in the market place. MSWG said that minority shareholders like to take simple solutions if they do not agree with any resolutions, and that is to sell all their shares. MSWG stressed that what they would be promoting is to make the minority shareholders realise their rights and use it before making any decision to dispose their shares. This move is viewed as highly positive as when Public Listed Companies (PLCs) strictly follows the CG guidelines, foreign investors will have the confidence to invest in the country. MSWG's objectives are to become the think-tank and resource centre for the minority shareholders. The objective is to influence the decision-making processes in PLCs, to take direct action against the management of PLCs on behalf of aggrieved minority shareholders, and to continuously monitor for breaches of and non-adherence to good CG practices in PLCs.

CONCLUSION

The discussion in this article concludes that effective and sound corporate governance practices are an important and significant part of the everyday business in the corporate market. When they are put in place, they can promote efficient use of resources both within the firm and the larger economy and will also enable the market to attract low-cost investment capital when both the domestic and international investor confidence is enhanced. Since the board of directors as the agent of the shareholders have been identified as the key corporate governance control mechanism, albeit an internal one, it is only appropriate that board effectiveness should be an area where more research on its roles, functions and organisation should be further carried out. For corporate boards

to be effective, they need capable directors (both executive and non-executive directors including those that are truly independent), with good leadership and high ethical standards.

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