MALAYSIAN CORPORATE GOVERNANCE REGULATION:
BEFORE AND AFTER THE ASIAN FINANCIAL CRISIS

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Abstract: This paper discusses the development of corporate governance regulation in Malaysia, with particular attention being paid to the period before and after the Asian Financial Crisis of 1997-98. It attempts to show that while regulatory oversight of corporate governance was introduced soon after the country's independence, the pace of regulatory reforms, such as on takeover and mergers, board composition and functions, and other disclosure reporting accelerated from the middle of the 1980s to mid 1990s. It was, however, the Asian Financial Crisis that prompted more resolute reforms. The paper concludes by drawing several observations from the discussion, and opined that the corporate governance regulatory reforms that were introduced immediately before and after the Asian Financial Crisis have contributed to the resilience of the Malaysian corporate sector.

Key words: Asian Financial Crisis, corporate governance, Malaysian reforms, regulation.

I. INTRODUCTION

In 1997, Thailand experienced a financial crisis, which rapidly spread to its neighboring countries, including Malaysia. Abrupt and huge outflows of capital funds and subsequent central bank interventions severely disrupted the financial system and drained the governments' foreign reserves. While banks were among the first to feel the crunch, within months the crisis worsened from financial to economic in nature. As a result, a large number of business corporations in these Southeast Asian countries experienced severe difficulties. Business activities and revenue collection dwindled and debt problems became rampant. Large numbers of workers were displaced. Weak corporate governance has been cited as a significant contributing factor leading to the crisis (Kim 1998, Mitton 2002). The attention accorded to corporate governance issues sometimes gives the impression that corporate governance problems are peculiar to this part of the world.

However, this cannot be further from the truth. Debates and actions on corporate governance have been taking place in the developed economies well before 1997. In the U.K., for example, concerns about standards of financial reporting and accountability were heightened by high profile financial collapses of BCCI and Maxwell Corporation. The Cadbury Committee was consequently set up in 1991. Subsequent measures included the establishment of the Greenbury Committee in 1995, to address controversies over excessive directors' remunerations among newly privatized utilities (Ow-yong & Cheah 2000). In the U.S., the collapse of Enron in 2001 and Worldcom in 2002 brough to light serious and widespread financial irregularities in the world's foremost economy. the scandals caused Arthur Anderson, one of the world's big five accounting firms to wind up. We therefore observe that corporate governance issues are universal and global in nature. Consequent to financial and corporate scandals and corporate governance lapses, the ways corporations are governed have now come under even greater scrutiny. Wide ranging initiatives involving nearly all aspects of the corporation have since taken place in most countries. This paper attempts to examine the development of corporate governance in Malaysia, by comparing the reforms undertaken by the government before and after the Asian Financial Crisis of 1997-98.

II. MALAYSIAN CORPORATE GOVERNANCE REFORMS BEFORE THE ASIAN FINANCIAL CRISIS

Being a British colony for over 100 years, a large number of Malaysian institutions are in fact based on British traditions and practices. As a result of British legacy, Malaysia practices a common law system of government, together with a corporate law regime that is largely based on other Commonwealth jurisdictions. For example, the Malaysian Companies Act 1965, which is the main legislation governing company law in the country, was developed based largely on Australia regulations (Ow-yong & Cheah 1999).

Over the years, however, greater variations have been incorporated and more institutions relating to corporate governance created; both to take into account local practices and circumstances, and to accommodate demands of the rapidly growing economy.

After the separation of Singapore from Malaysia in 1965 and the split in their currency parity in 1973, the Kuala Lumpur Stock Exchange was created in 1973. In 1983, the Securities Industry Act 1983 was enacted to make provisions with respect to stock exchanges and persons dealing in securities, and for certain offences relating to trading in securities. In 1987, the Panel on Takeovers and Mergers introduced the Malaysian Code on Takeovers and Mergers 1987, and subsequently issued various practice notes to regulate corporate activities on takeovers and mergers (Song 2007). In 1993, a body corporate known as 'Securities Commission' was incorporated via the Securities Commission Act 1993. Vested with investigative and enforcement powers, the Securities Commission was established to protect the investor, besides its regulatory function and the no-less-important mission of promoting the development of the securities and futures markets in Malaysia (Securities Commission 2008).

Attention and actions have also been given to issues of independent directors and audit committees. As early as ten years before the Asian Financial Crisis started, Malaysian stock exchange listing rules already required that independent directors be emplaced on boards of public listed companies. On the other hand, the history of audit committee in Malaysia began when the central bank (Bank Negara Malaysia) prescribed, in 1985 the establishment of the audit committee for financial institutions. In 1991, the Malaysian Institute of Accountants and the Malaysian Association of Certified Public Accountants and the Institute of Internal Auditors submitted a memorandum to the Malaysian government recommending that the audit committee be made mandatory for companies seeking listing on the stock exchange. Subsequently the requirement of the establishment of Audit Committee was incorporated (in 1993) into the listing rules of the stock exchange. All listed companies were required to set up an audit committee comprising a majority of directors independent of management (Muhamad Sori & Karbhari 2006).

Efforts also began in 1995 to shift the basis of market regulation The Securities Commission, which inherited the merit-based regulation regime when it was established in 1993, decided to move away from it. In 1995, it began to undertake efforts to shift the onus of assessing the merit of securities to the market and the investor by adopting a five-year phased move toward a disclosure-based regime. The disclosure-based system required higher level as well as more continuous flow of timely and accurate disclosure of relevant information to enable investors to make informed and reasoned investment decisions (Securities Commission 1999). The move involved the amendments to a number of related legislations, including the Securities Commission Act 1993, the Securities Industry Act 1983, the Securities Industry (Central Depositories) Act 1991, as well as the introduction of several new regulatory codes and guidelines (e.g. Policies and Guidelines on Issue/Offer of Securities, Guidelines on Due Diligence Practices 1996). At the same time, it also required correspondingly higher standards and more active role on the part of company directors. In the following year (1996), the Code of Ethics for Directors was introduced. This code adopted the principles of transparency, integrity, accountability and corporate social responsibilities, and covered three main areas: corporate governance; relationship with shareholders, employees, creditors and customers; and social responsibilities and the environment (Lai 2007).

The Securities Industry Development Centre, set up by the Securities Commission in 1994, complemented other efforts of promoting corporate governance by organizing training, education and research. Besides regular workshops and seminars, its monthly publication, *the Investor Digest*, educates investors on shareholders' rights, recourse for investors, and alert investors of potential pitfalls and scams.

Due to international developments on corporate governance and some domestic corporate scandals (for example the government-owned Perwaja steel mill) in the mid-1990s, a number of new initiatives were undertaken, well before the occurrence of the 1997 Asian Financial Crisis, to further reform

corporate governance in Malaysia (Ow-yong & Cheah 2000). Efforts to revamp the Code on Takeovers and Mergers began in 1996 as a move towards creating more 'corporate governance conscious' boards of directors (Ow-yong & Cheah 1999). Just months prior to the outbreak of the 1997 crisis, the Financial Reporting Act was legislated in Parliament to introduce a new financial reporting framework, with the establishment of the Financial Reporting Foundation, and the Malaysian Accounting Standards Board.

III. MALAYSIAN CORPORATE GOVERNANCE REFORMS AFTER THE ASIAN FINANCIAL CRISIS

By far the most significant single event in institutionalizing corporate governance reforms in Malaysia is the establishment of the High Level Finance Committee on Corporate Governance. It was established as part of a series of measures announced by the then Minister of Finance on 24 March 1998 to boost and stabilize the Malaysian economy (Finance Committee Report 1999). The Committee sat down quickly to carry out its tasks, and released the Finance Committee Report in the early part of the following year. After a review of the corporate governance situation of the country, the report made a comprehensive and far-reaching package of proposals, which may be summarize into the following three areas:

a) Reform of law, regulations and rules;
b) Development of a set of principles and best practices for good governance; and
c) Promotion of governance education and training and establishment of related institutions.

While the proposals may be reactive (after the occurrence of the financial crisis which has hit the country severely), they were nonetheless timely. More importantly, the government gave solid backing and provided powerful support to ensure that the implementation of most of the proposals were not seriously impeded.

a) Between 1997 and 2000, a number of legislative and non-legislative changes were introduced. For example, the Securities Industry Act 1983 was amended in April 1998 to enhance the Securities Commission's powers (including over directors and CEOs), and to institute civil remedies against offenders for insider trading. The Companies Act 1965 was also amended to curb the abuses of 'asset shuffling' whereby a company could acquire the shares or assets of another company in which a shareholder or director has a substantial shareholding. Listing Requirements, administered by the Kuala Lumpur Stock Exchange were amended several times within the first three years after the occurrence of the Asian Financial Crisis in mid 1997. Among others, the changes were designed to further protect minority shareholders and to require more timely disclosure in the form of quarterly reporting of financial information. More significantly, a revised code, the Malaysian Code on Takeovers and Mergers 1998 came into force on January 1, 1999. This new code addressed deficiencies found in the 1987 code, and sought to protect minority interests and to ensure higher standards of disclosure and corporate governance.

b) Under the auspices of the High Level Finance Committee, an industry-led working group came up with the Malaysian Code of Corporate Governance (MCCG), which was launched in March 2000. The MCCG set out thirteen principles of conduct and thirty-three best governance practices. In the following year, the Listing Requirements of the Kuala Lumpur Stock Exchange were comprehensively revamped. Among the major changes, all public listed companies are mandated to disclose their compliance with the MCCG in their annual reports.

c) A broader base for effective corporate governance involves efforts to upgrade corporate governance education and training. These include attempts at enhancing public and investor awareness of corporate governance in general, and upgrading the knowledge and competency of company directors in particular. A major strategy is the introduction of mandatory training for company directors by the Kuala Lumpur Stock Exchange. The Securities Industry Development Centre mentioned earlier also stepped up its activities at promoting education and training of corporate governance. Another major recommendation of the Finance Committee Report is the setting up of the Minority Shareholder Watchdog Group (MSWG). The *raison d'etre* for the MSWG was to encourage independent and proactive shareholder participation and activism. MSWG was officially incorporated in August 2000, funded for the first three years by five large government-linked investment agencies (Cheah 2005).

In the same month (March 1998) as the establishment of the High Level Finance Committee on Corporate Governance, the Malaysian Institute of Corporate Governance was incorporated with a grant of RM250,000 from the Securities Commission. Its objectives are to enable its members to address corporate governance issues in the public arena, and its chairman was immediately included in the High Level Finance Committee.

IV. CONCLUDING REMARKS

From the above discussions, several observations may be made.

1. It can be seen that the nature and scope of corporate governance regulation in Malaysia evolved concomitant with the rapid development of the corporate sector and economic expansion of the economy. With the passage of the Companies Act 1965 and the establishment of the Kuala Lumpur Stock Exchange in 1973, some structure of legislative as well as non-legislative regulations has been put in place to streamline the governance of corporations and to protect the interests of investors in the initial years of the country's independence. Efforts to further strengthen the governance aspects of Malaysian corporate life gathered momentum in the 1980s and 1990s as the Malaysian economy entered into a high-speed phase of economic development. Increasing corporate activities and interlocking share ownership which is common among Asian businesses, led to the codification, in 1987, of checks and balances on takeover and mergers. The composition, functions and operations of the board of directors became increasingly regulated when the stock exchange's listing requirements imposed rules on independent directors and the audit committee.

2. International concerns on corporate governance breaches and the resultant governance reforms in countries such as the United Kingdom in the decade preceding the mid 1990s inevitably brought about greater urgency to reform Malaysia's corporate governance, which has also been affected by several high profile domestic corporate scandals. We can therefore conclude that corporate governance reforms in Malaysia commenced long before the Asian Financial Crisis of 1997-98. Furthermore, the pace of reforms gathered even greater momentum in the mid 1990s, not least because of developments overseas (such as the establishment of the 1991 Cadbury Committee and the 1995 Greenbury Committee in the United Kingdom) and domestic exigencies arising from some corporate failures.

3. It can also be seen from our discussion in this paper that the onset of the Asian Financial Crisis beginning in July 1997 indeed led to even greater urgency and more resolute changes being undertaken to reform Malaysian corporate governance. The formation of the High Level Finance Committee and setting up of the Malaysian Institute of Corporate Governance in March 1998 are landmarks which led to the introduction of a great number of subsequent reforms. Besides legislative and non-legislative regulatory changes, the implementation of the Malaysian Code of Corporate Governance, which were incorporated into the stock exchange's listing requirements, may be considered the most far-reaching in terms of impact on governance practices of public listed companies in the country. Education, training and the creation of Minority Shareholder Watchdog Group and Malaysian Institute of Corporate Governance have helped to promote greater awareness among company directors and the investor public; and enhance the standard of practice among listed corporations. It must be admitted, therefore, that the occurrence of the Asian Financial Crisis has triggered more urgency, and prompted more concerted and comprehensive reforms.

4. One salient characteristic of Malaysia's corporate governance initiatives and reforms is that they are largely public sector-led (Cheah 2005). In fact the post 1997-98 wave of corporate governance initiatives began with the formation of the High Level Finance Committee, which constituted part of a series of measures announced by the Minister of Finance on 24 March 1998 to boost and stabilize the distressed Malaysian economy. The formulation of the Malaysian Code on Corporate Governance, the revamp of KLSE Listing Requirements and the other measures were all direct government initiatives. The government is therefore seen to play a definitive, direct and pivotal role in corporate governance reforms in Malaysia.

This, however, is not surprising. As a matter of fact, the public sector has played a prominent role in most East Asian countries, intervening extensively in most spheres of economic activities (World Bank 1993). Theoretically, corporate governance reform is a public good. In the absence of government intervention, it may well be under-provided through market forces.

5. The Malaysian economy was adversely impacted in 2008-09 as a result of the Global Economic Crisis. Having emerged from the Asian Financial Crisis a decade ago, however, the economic structure and the financial and corporate sectors have, to some extent, cleansed themselves of some of the excesses. It may not be too to say that the corporate sector has been considerably strengthened, and thus was in a better position to absorb the external economic shocks. In this sense, credit could perhaps be given to the series of resolute reforms, especially those undertaken after the 1997-98 crisis, for their contribution in reinforcing the corporate sector, rendering it more prepared for, and more resilient in the face of the devastating effects of the 2007-09 Global Economic Crisis.

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