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Chapter 5

Corporate governance

The degree to which corporations observe basic principles of sound corporate governance helps to determine investment decisions, influencing the confidence of investors, the cost of capital, the overall functioning of financial markets and ultimately the development of more sustainable sources of financing.

Malaysia has taken significant steps to strengthen its corporate governance framework, especially after the Asian financial crisis. This chapter analyses some of the government's far-reaching reforms ranging from strengthening minority shareholder rights to enhanced enforcement measures. The role of government-linked companies (GLCs) and the associated GLC Transformation Programme as part of the government's overall drive to increase competition and opportunities for private investment is also addressed. Given the recent momentum of corporate governance reforms, Malaysia and its private sector could now benefit from consolidation of the various initiatives.

Corporate governance reform is an important aspect of broader reforms aimed at securing an environment attractive to both domestic and foreign investors and that enhances the benefits of investment to society. The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for investment decisions. By improving disclosure and transparency, corporate governance helps channel capital to those firms with the most profitable opportunities, thus improving the allocation of capital within the economy. It also gives greater confidence to all investors, small and large, domestic and foreign, that their rights will be protected, thus potentially increasing the supply of capital available.

The government has made significant reforms in the area of corporate governance since the Asian financial crisis of 1997-1998. The weaknesses of the regulatory frameworks for business and finance are often pointed to as key contributors to the crisis (World Bank, 2000). In response, the government created the High Level Finance Committee which prepared a report in 1999, launched the Malaysian Corporate Governance Code and created the Minority Shareholders Watchdog Group (MSWG), both in 2000. Their main objective was to rectify and strengthen weak legal and regulatory frameworks, particularly for smaller shareholders and businesses, who suffered hard from the Asian crisis.

Since this initial reform wave, the government has kept up momentum, including preparing the Capital Market Master Plans (CMP1 in 2001 and CMP2 in 2011) (see Chapter on Financial sector development), revising the Code of Corporate Governance in 2007, and issuing the Corporate Governance Blueprint 2011, which outlines strategic initiatives aimed at reinforcing self- and market discipline, and most recently, the Malaysian Code on Corporate Governance 2012 (MCCG, 2012). As of May 2012, Malaysia's stock market capitalisation stood at RM 1 320 billion with a total of 929 listed companies, more than in its ASEAN peers (SCM, 2012 and OECD, 2011).

Especially interesting is the country's framework for its state-owned enterprises or government-linked companies (GLCs) as they are generally referred to in Malaysia. GLCs are subject to high standards of governance, notably since the crisis. In that respect the GLC Transformation Programme launched in 2005 is showing results in terms of raising the governance standards in GLCs.

Malaysia's progress in strengthening its corporate governance framework is recognised internationally. The World Bank's Corporate Governance *Report on the Observance of Standards and Codes* (CG ROSC), which draws on the OECD *Principles of Corporate Governance*, awarded the highest score to Malaysia in 2006 for its compliance with International Financial Reporting Standards (SCM, 2011). Malaysia has recently also received strong ratings from the World Bank CG ROSC 2012: out of the six OECD principles, Malaysia scored highest in terms of equitable treatment of stakeholders, enforcement and institutional framework, as well as disclosure and transparency.

The government nevertheless needs to tackle a number of challenges to be able to benefit fully from its corporate governance related reforms. While the framework aims to promote greater internalisation of the culture of good governance, the practice of box ticking continues to persist, as well as a corporate tendency to stick to minimum requirements. The government's role in facilitating shareholder participation and protection also needs to be stepped up, such as through public awareness campaigns. Also, efforts underway to improve GLC governance and to expose GLCs to open competition with the private sector on a level-playing field need to be maintained, given the important role GLCs play in the economy. These need to be considered in an overall competition policy framework to increase private sector participation in the economy, which is a government priority.

Main features of Malaysia's corporate governance framework

Asia today is, in terms of corporate governance, almost unrecognisable from the Asia of 1997. The 1997 Asian financial crisis led many Asian countries to reform financial and corporate institutions. One key facet of this structural change was corporate governance reform. Indeed, since the crisis many countries in Asia have enhanced and transformed their corporate governance systems, resulting often in stronger regulation, better resourced regulators, new institutions and an increasingly involved shareholder base. Malaysia has undertaken a great deal of reforms in these areas.

The government has promoted a more coherent and consistent regulatory framework with both self-regulation and statutory provisions. Figure 5.1 highlights some of the major corporate governance milestones in Malaysia since 1999. Furthermore, various measures have been taken by regulators to ensure that the existing corporate governance framework continues to promote overall economic performance and transparent and efficient markets. Table 5.1 contains the major laws and regulations that make up the corporate governance framework and shape practices in Malaysia.

The Securities Commission Malaysia issued the Corporate Governance Blueprint in July 2011, which represents one of the first deliverables of CMP2

Table 5.1. **Major laws and regulations affecting corporate governance**

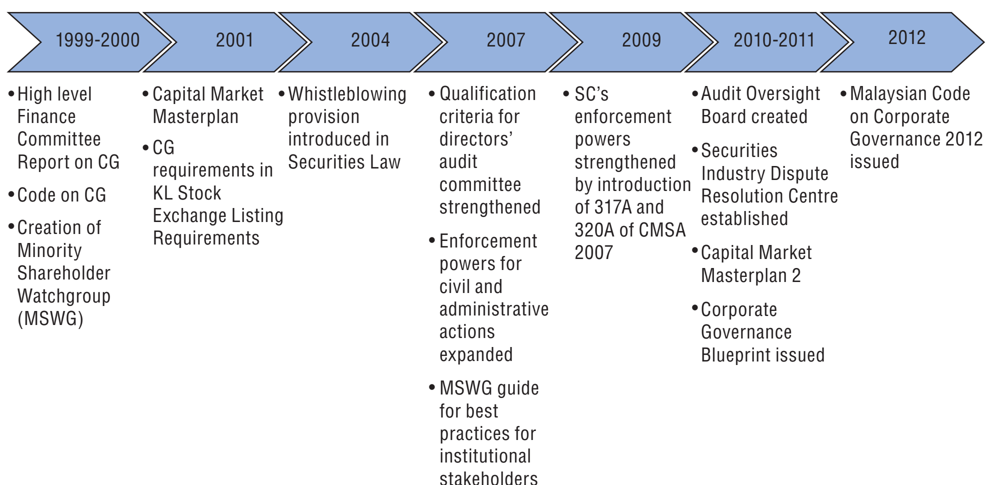
The Companies Act 1965 and amendments in 2007 (*www.ssm.com.my*)
Banking and Financial Institutions Act 1989 (*www.bnm.gov.my*)
Development Financial Institutions Act 2002 (Act 618) (*www.bnm.gov.my*)
The Financial Reporting Act of 1997(*www.masb.org.my*)
The Bursa Malaysia Listing Requirements (*www.bursamalaysia.com*)
Securities Commission Act 1993. This legislation covers all amendments made including the most recent Securities Commission Amendment Act 2010
Capital Markets and Services Act 2007 (*www.sc.com*)
Malaysian Code on Corporate Governance released in 2012 (SCM)

Source: OECD (2011), *Reform Priorities in Asia: Taking Corporate Governance to a Higher Level*, Paris. and Securities Commission of Malaysia (2012).

and uses the OECD *Principles of Corporate Governance* as a reference, as well as priorities agreed by the OECD-Asian Roundtable on Corporate Governance. The Blueprint is an affirmation of the Commission's commitment to achieve excellence in corporate governance through strengthening self- and market discipline and promoting the internalisation of a good corporate governance culture. Boards and shareholders are encouraged to embrace the idea that good business includes ethical and sustainable behaviour, going beyond the desired financial bottom line (SCM, 2012).

While the Code of Corporate Governance in 2001 was a significant step in establishing a more appropriate regulatory framework, its revision in 2007 went further to improve self-regulation by strengthening the roles and responsibilities of the board of directors, particularly independent directors

Figure 5.1. **Corporate governance reform timeline in Malaysia (1999-2012)**



and the audit committee. Whistle-blowing provisions were also introduced in 2004. Since 2007, Malaysia requires auditors who resign or are removed from office to disclose to the regulators the reasons, except in cases where the auditor does not wish to seek re-appointment or is not re-elected at the annual general meeting (OECD, 2011).

The Malaysian Code on Corporate Governance released in March 2012 supersedes the revised Malaysian Code on Corporate Governance. The new Code, which follows international best practices, is a key deliverable of the Blueprint and is aimed at enhancing board effectiveness through strengthening board composition, reinforcing the independence of directors and fostering the commitment of directors. It also encourages companies to put in place corporate disclosure policies that embody principles of good disclosure. Companies are also encouraged to make public their commitment to respect shareholder rights (SCM, 2012).

In addition to the 2012 Code, a number of regulations that frame corporate governance in Malaysia, including the *Companies Act* (1965), the *Securities Commission Act* (1993), and the *Capital Markets and Services Act* (CMSA, 2007). The texts, as well as their recent updates and applications, are presented in more detail below.

The Companies Act (1965)

Corporate law in Malaysia is primarily set out in the *Companies Act* (1965) which is based on the UK *Companies Act* (1948) and the Australian *Uniform Companies Act* (1961) and which incorporates the following provisions:

- functions and powers of the board;
- duty and liability of directors and officers;
- meetings and members' rights at meetings; and
- regulation of related-party transactions.

In 2007, the Act was amended so as to:

- clarify directors' duties;
- strengthen as well as clarify regulation of related party transactions;
- enable shareholders to take derivative action;
- allow the use of technology to facilitate members meetings in more than one venue;
- extend notice duration of AGMs. Now, a minimum of 21 days of prior notice must be given by a public company before it convenes its AGM;
- enhance auditor's duty by imposing a statutory obligation on auditors of public companies or companies controlled by a public company to report to the Registrar, should they become aware of a serious offence committed

involving fraud or dishonesty against the company when carrying out their duties as auditor; and

- provide statutory protection to whistleblowers.

Securities Commission Act (SCA – 1993)

The *Securities Commission Act* 1993 was amended by the *Securities Commission Amendment Act* 2010 which established an Audit Oversight Board. The Commission, through the Board, provides independent oversight and regulation over external auditors of public interest entities to improve compliance with auditing standards. In this regard, the Board is responsible for registering individuals and firms who wish to audit the financial statements of such entities. The Board also takes enforcement action against registered auditors for non-compliance with auditing and ethical standards. The Board can impose sanctions of up to RM 500 000 and can suspend registrations. It began operations on 1 April 2010. On 28 February 2011, the Auditor Registration Application System was launched, allowing auditors to submit applications for registrations electronically. This aims to make registration more efficient while easing the creation of a database for the benefit of the Board and auditors.

The Capital Markets and Services Act (CMSA – 2007)

In 2007, the government streamlined the corporate governance framework by consolidating several laws, namely the *Securities Industry Act*, *Futures Industry Act* and Part IV of the *Securities Commission Act,* into a single legislation: the *Capital Markets and Services Act* (CMSA). It also incorporates several new provisions that enhance corporate governance standards, such as by giving the Securities Commission the right to intervene where interest is prejudiced and by enhancing its ability to take civil action for market misconduct offences for both securities and futures contracts. Previously, the Securities Commission could only take civil action for offences relating to securities and not for futures contracts. The Commission can now also bar unfit persons from becoming a CEO or director of a public company.

Bursa Malaysia has also issued a new set of listing requirements for its Main Market and ACE Market (Bursa Malaysia's secondary market, short for "Access, Certainty, Efficiency"). These new listing requirements came into effect on 3 August 2009. The Main Market replaces the first and second board of Bursa whilst the ACE market replaces the MESDAQ Market. The listing requirements oblige listed companies to disclose material information to the market in a timely manner and to comply with the requirements pertaining to related party transactions and to corporate governance. On the latter,

Malaysia, together with Hong Kong (China), Singapore, Pakistan and Chinese Taipei, is one of the few Asian countries with such a requirement (OECD, 2011).

The board of a listed issuer is also required to provide a statement in the annual report on how it has applied the best practices set out in the Corporate Governance Code. In case of non-compliance with the Code, the statement must identify the areas and reasons for the non-compliance.

Enforcement

A number of agencies are in charge of enforcing different aspects of corporate governance in Malaysia (Table 5.2). Co-ordination has been addressed through both formal and informal mechanisms, e.g. joint investigations, sharing of findings and joint charges (SCM, 2011). A series of reforms to improve enforcement have been introduced over recent years, including the establishment of the Oversight Board mentioned above. Also, the SCM was allowed to pursue civil action and its powers were enhanced in 2010 to be able to prosecute company directors and officers for causing wrongful losses to the company.

There continue to be some constraints, however, with regards to the capacity of public agencies to effectively enforce Malaysia's corporate governance standards. The Securities Commission in its *Corporate Governance Blueprint* recommended that private sector initiatives be explored further and that related funding issues be addressed (SCM, 2011).

Table 5.2. **Corporate governance enforcing agencies in Malaysia**

Laws/Regulations	Enforcing Agency
Capital Markets and Services Act	Securities Commission Malaysia
Companies Act	Companies Commission of Malaysia
Banking & Financial Institutions Act	Bank Negara Malaysia
Penal Code	Police
Malaysian Anti-Corruption Act	Malaysian Anti-Corruption Commission
Bursa Listing Requirements	Bursa Malaysia

Voluntary corporate governance initiatives and training

Despite some shortcomings in corporate reporting that will be highlighted below, many companies are adopting standards and best practices beyond the minimum imposed by the law. This is evident from the Securities Commission's own findings, as well from the MSWG's *Corporate Governance Index* reports. The challenge lies in encouraging more companies to follow suit. In view of promoting and developing an ethical and healthy corporate culture, various corporate governance awards have been given, including the *National Annual Corporate Report Awards* and the Malaysian *Corporate Governance Index* Award.

It is hoped that these awards will incentivise more listed companies to go beyond the minimum compliance in form.

Various organisations have been established to promote a good corporate governance culture, such as the MSWG (mentioned above) and its *CG Index* and the Malaysian Investor Relations Association, which was established in June 2007 by the Stock Exchange of Malaysia and the Capital Market Development Fund. It is the first and only professional association for investor relations in Malaysia. Its membership comprises public-listed companies, investment banks, brokerages and intermediaries and investor relation service providers. Its objectives and functions include supporting members through seminars, workshops and policy briefs; conducting education and training programmes to raise the levels of investor relations in Malaysia; and "hand holding" companies who are keen on establishing an investor relation function and programme.

The Association offers an incentive programme to help public-listed companies to set up investor relations programmes internally. It has also hosted Investor Expo briefings and produced an Investor Relations Manual & Workbook to guide public-listed companies on principles and management of investor relations.

In Malaysia, directors' training is required where the individual is appointed as a director of a listed issuer for the first time or is a director of a company that is seeking listing on the exchange. In its efforts to improve the effectiveness and capacity of the boards of its GLCs, the government launched a number of initiatives, leading i.a. to the establishment of the Directors Academy in Malaysia (Box 5.1) (OECD, 2010).

Malaysia has several programmes focusing on continuing education for directors. On June 2009, Bursa Malaysia issued the *Corporate Governance Guide: Towards Boardroom Excellence* and collaborated with several organisations such as the Malaysian Institute of Accountants, the Institute of Internal Auditors and the Malaysian Institute of Corporate Governance to hold training programmes for directors. The Companies Commission of Malaysia also organises training programmes specifically for non-listed directors. In 2009, the Malaysian Alliance of Corporate Directors was established by directors to provide education, information and networking opportunities for corporate directors.

Other voluntary initiatives to promote good corporate governance include the Bursa/SCM CG week, during which participants are exposed to various corporate governance initiatives and are able to network with corporate governance practitioners. Bursa Malaysia also released its CG Guide and established a CG department to work with public-listed companies to raise corporate governance standards.

Box 5.1. **The Malaysian Directors Academy**

One of the main policy thrusts of the GLC Transformation Programme (see below) is the need to upgrade the effectiveness of GLC Boards through learning. This led to the establishment of the Malaysian Directors Academy to address board performance by equipping directors of GLCs with world class knowledge, skills and a mindset to perform to a consistently high standard. To be an effective director, a number of performance criteria are critical, including understanding the boundaries between the board and management, and active problem solving with both the board and key management on strategic issues, whilst leveraging networks and managing multiple stakeholders proactively.

For new and potential directors, the transition from a management role to a director's role has to be addressed in a holistic manner. With the evolving strategic, operational and geographic priorities of many GLCs, directors with deep commercial, functional, geographical or relevant industry skills, knowledge and experience are required.

The Academy seeks to address this by delivering four integrated functions in a distinctive way, namely: facilitate sharing of learning through forums, linkages and databases of best practices to build directors' capabilities; research and develop Malaysian-related case studies to assist directors in building knowledge on how to handle specific situations; arrange "on-the-job" learning and coaching which will be customised to an individual director's needs; and enhance existing training and development programmes to meet the needs of directors.

The Academy recognises the different types of directors and the complexities of their roles and relationships: learning interventions cater to the differing roles and issues relevant to each category. The Academy seeks to provide world-class programmes. To achieve this, it will collaborate with leading international institutions that specialise in designing and deploying programmes at Director's level, including the International Institute for Management Development based in Lausanne, Switzerland. It is also in discussions currently with other local and international institutions to identify potential areas for collaboration.

Source: OECD (2010), *Policy Brief on State-Owned Enterprises in Asia – Recommendations for Reform.*

Malaysia and the OECD Principles of Corporate Governance

Malaysia has undergone a voluntary assessment by the World Bank, i.e. the Report on Standards and Codes (ROSC) in 2005, based on the OECD *Principles of Corporate Governance*. Malaysia has also been an active participant in the OECD Asian Corporate Governance Roundtable, most recently in

October 2012 in Tokyo. The Roundtable report *Reform Priorities in Asia: Taking Corporate Governance to a Higher Level* includes the Securities Commission's responses to an OECD questionnaire on corporate governance development and progress in Asia which served as a useful stock-taking exercise on how Malaysia and other Asian economies have implemented the OECD *Principles of Corporate Governance*.

Other regional initiatives can also contribute to raising corporate governance standards at company level in Malaysia. A pilot programme of an ASEAN Corporate Governance Scorecard, based on the OECD *Principles of Corporate Governance*, was launched in 2012 to rank the top 30 public companies in participating ASEAN member economies: Malaysia, Indonesia, Philippines, Singapore, Thailand and Viet Nam (SCM, 2012).

Shareholder rights in Malaysia

Framework to ensure equitable treatment of shareholders

In order for investors to buy shares, they need to be confident that their property rights are properly recognised and protected. The ownership structure has important implications for the corporate governance framework. In many economies, major shareholders control most companies, in some cases through differential voting rights or complex ownership and control structures that allow them to maintain control with relatively little equity. In other cases, ownership is controlled by the state, raising additional governance challenges, as will be seen below.

Controlling shareholders have strong incentives to monitor closely the company and its management and can have a positive impact on the governance of the company, but their interests may also conflict with the interest of minority shareholders. This conflict is most destructive when the controlling shareholders extract private benefits at the expense of minority shareholders. The OECD *Principles* provide that "[t]he rights of stakeholders that are established by law or through mutual agreements are to be respected." Companies should raise awareness of stakeholders' legally protected rights and should translate this awareness into everyday actions.

The effectiveness of minority shareholders' rights form part of the framework for attracting foreign investors, especially if this investment is promoted through joint ventures with local partners. This is of particular relevance in Malaysia, where, in some sectors (see Chapter 2 on investment policy), foreign participation in domestic companies is restricted to a minority share.

Various provisions in the *Companies Act* of Malaysia ensure that shareholders are treated fairly and equitably and are able to exercise their rights. These include the right:

- to requisition general meetings;
- to attend, vote and speak at general meetings;
- to appoint a proxy to attend, vote and speak on behalf of the shareholder at general meetings;
- to put forward any resolution e.g. appointment and removal of directors when a certain threshold is reached;
- of members to give their approval for disposal by directors of a company's undertaking or property;
- for shareholders to demand poll voting, especially for certain types of resolutions such as related party transactions and remuneration of directors; and
- of members to give their approval for related-party transactions.

Moving forward, the Securities Commission recognises that there are other areas that can be further improved, such as proxy and poll voting. As of 3 January 2012, Bursa Listing Requirements (provision 7.21 A) allow a member to appoint any person as a proxy to attend and vote at the meeting. There is no restriction as to the qualification of the proxy. The Commission chairs the Working Group C of the Corporate Law Reform Committee that has reviewed the general meeting provisions in the *Companies Act* and has made various recommendations (Box 5.2) to reform the law on general meetings.

Furthermore, with a view to enhancing the corporate governance framework, the Securities Commission recently announced the establishment of a Corporate Governance Consultative Committee which will provide strategic direction, views and advice in the development of a new five-year Corporate Governance Blueprint outlining an action plan to further raise the standards of corporate governance in Malaysia. The Committee is chaired by the Chairman of the Securities Commission and comprises 11 senior industry participants and experienced professionals from Malaysia and abroad. The new blueprint aims to be comprehensive and forward-looking, covering strategic priorities to further enhance Malaysia's corporate governance standards and identity. In this regard, treating shareholders equitably and enhancing shareholders' participation in the decision-making process feature particularly high on the committee's agenda.

The blueprint was released in July 2011, containing 35 recommendations to be implemented over a five-year period. In developing the blueprint, according to the government, extensive research and international benchmarking, such as the OECD *Principles of Corporate Governance*, were

Box 5.2. **Recommendations for reform of the Companies Act by the Corporate Law Reform Committee**

- The act should allow for other modes of communications (apart from the requirement that notices of meetings should be given personally or be sent by post to shareholders) if shareholders agree;
- Section 149(1)(b) of the act which currently provides that only qualified persons such as an advocate, an approved company auditor or persons approved by the Registrar may be appointed as a proxy be deleted;
- the act should be amended to facilitate direct absentee voting/postal voting/electronic voting; and
- Section 149 which currently provides that proxies can only vote by way of a poll be amended to allow proxies to vote by a show of hands, but where a member appoints more than one proxy, the proxies should not be allowed to vote by a show of hands.

Some of these reforms have already been implemented, such as enabling the use of technology to facilitate the holding of general meeting in more than one venue.

Source: Securities Commission of Malaysia (2011).

undertaken to ensure that the recommendations are sufficiently robust to bring about positive changes to the Malaysian corporate governance landscape. The reasonableness, efficacy and validity of the recommendations discussed with both local and international stakeholders.

Procedures and institutional structures to protect shareholder rights

Although there are no specific bodies in Malaysia to mitigate or arbitrate disputes related to corporate governance, the Kuala Lumpur Regional Centre for Arbitration does arbitrate and deal with any disputes arising out of contracts, provided that there is an arbitration clause in the contract. This could include corporate governance matters (OECD, 2011) (see also Chapter 3). There are also four Sessions Courts in Malaysia dealing with commercial and capital market-related cases. In September 2009, the High Court set up two new commercial courts dedicated to hearing commercial cases in banking, finance and insurance. The Securities Industry Dispute Resolution Centre was also established in 2011 to facilitate small claims resolutions by investors (Bursa Malaysia, 2011).

Beyond the courts and other bodies, Malaysia disposes of various legal remedies that can be sought by shareholders when their rights are violated, including the right to sue the company. These remedies include:

i) Right provided under the Memorandum and Articles of Association

Where a right provided for under the company's Memorandum and Articles of Association is breached, the shareholder can sue the company by virtue of breach of contract.

ii) Statutory Derivative Action

Where a wrong is committed by a company, but the company is controlled by the wrongdoer, the shareholder may bring an action on behalf of the company, by initiating a statutory derivative action.

Essentially, these provisions allow a shareholder to bring, intervene in, or defend an action on behalf of the company notwithstanding that the matter before the court is ratified by the company and leave of the court is obtained. The provisions provide that the court in granting leave will take into consideration that the complainant is acting in good faith; and it appears *prima facie* to be in the best interest of the company that the application for leave be granted.

iii) Oppression Remedy under the Companies Act

Where the affairs of the company or the powers of the directors are considered to reflect unfair prejudice against a shareholder, the aggrieved shareholder can seek a remedy for oppression or unfair prejudice. The court has wide discretionary powers as to the type of remedial order it can make, including winding up the company. Other orders that the court may make include:

- directing or prohibiting any act or cancelling or varying any transaction or resolution;
- regulating the conduct of the affairs of the company in the future;
- providing for the purchase of the shares or debentures of the company by other members or holders of debentures of the company or by the company itself; and
- in the case of a purchase of shares by the company, providing for a reduction accordingly of the company's capital.

iv) Injunction

The *Companies Act* also provides that, where a person contravenes the act or attempts to do so, the Registrar or any person whose interest is affected by the contravention, may apply to the court to restrain the conduct of the first mentioned person.

The government has also implemented measures to monitor and prevent corporate insiders and controlling owners from extracting private benefits.

The *Companies Act* clearly states that a director of a company must act in the best interest of his company. Therefore, where a director furthers personal interests at the expense of the company, it is considered a breach of duty to the company. This obligation lists the situations where a director is said not to have acted in the best interest of the company, including:

- using the property of the company;
- using any information acquired by virtue of his position as a director or officer of the company;
- using his position as a director or officer;
- using any opportunity of the company; or
- engaging in business which is in competition with the company to gain directly or indirectly, a benefit for himself or any other person, or cause detriment to the company, without the consent of a general meeting.

v) Provisions pertaining to insider trading

Where any person, including a director who is in possession of price sensitive information, uses that information to buy and sell securities, that person can be convicted for the offence of insider trading under the CMSA, punishable by imprisonment for a term not exceeding 10 years and a fine of not less than RM 1 million. Any person who suffers loss or damage by relying on the conduct of a person who has breached these provisions is allowed to recover the amount of loss or damages by instituting civil proceedings. The Securities Commission may take a civil action against an insider or other person involved in the contravention.

Asian jurisdictions continue to experiment with introducing specialised courts and other mechanisms to strengthen enforcement. Malaysia has created new bodies within existing institutions focusing on strengthening enforcement capacity. For example, the government has set up an enforcement division in its stock exchange (OECD, 2011).

As mentioned above, the government has put in place various procedures to ensure that shareholders have the ability significantly to influence the company in both the *Companies Act* 1965 and the Bursa Listing Requirements. Amendments to the company's memorandum and articles of association require that the proposed amendments be passed by a ¾ majority of shareholders who have attended and voted at that meeting. Various measures could nevertheless be considered in order to increase the influence of shareholders on companies in Malaysia, such as by encouraging electronic voting which can promote shareholder participation in general meetings and can address some traditional problems associated with proxy voting, such as

proxy votes not being counted. The establishment of a credible electronic voting platform could be considered.

More generally, companies should be encouraged to show greater commitment to shareholder rights. Making information on shareholder rights publicly available can be effective in that regard, including by posting information on company websites and organising awareness campaigns. These manifest a commitment by companies to respect shareholder rights, while increasing the awareness of shareholders of their rights in a transparent manner.

The Malaysian Minority Shareholder Watchdog Group (MSWG) has been pivotal in providing a platform for collective shareholder activism on unethical or questionable practices by the management of public listed companies (Box 5.3). Such groups can be valuable in contributing to transparency and hence attractiveness of the investment climate.

Box 5.3. **The role of the Minority Shareholder Watchdog Group in Malaysia**

The Minority Shareholder Watchdog Group was established in 2000, sponsored by the capital markets regulator to enhance shareholder activism and to protect minority interests. Its mission is to help develop knowledgeable and active minority shareholders.

The Watchdog's more concrete objectives are to:

- become the forum on minority shareholders' experiences in the context of the Malaysian Code on Corporate Governance and the Securities Commission's Disclosure Based Regime and the Capital Market Master Plan;
- become the think-tank and resource centre for minority interest and corporate governance matters in Malaysia;
- develop and disseminate the educational aspects of corporate governance;
- become the platform for collective shareholder activism on unethical or questionable practices by management of public listed companies;
- influence the decision-making process in public listed companies as the leader for minority shareholders' legitimate rights and interests;
- monitor breaches and non-compliance in corporate governance practices by public listed companies; and
- report to regulatory authorities on activities against the interests of minority shareholders.

Each year, the MSWG publishes a Company Meeting Survey, a Dividend Survey and a Corporate Governance Survey.

Source: OECD (2010), *Policy Brief on State-Owned Enterprises in Asia – Recommendations for Reform*.

The MSWG and Bursa Malaysia launched the Corporate Governance Index in conjunction with the Corporate Governance Week in 2009. The Index is an extension of the annual MSWG CG Survey and aims to provide a reliable gauge for investors to rate local public listed firms based on their level of adherence to globally accepted corporate governance standards. It includes all listed companies on Bursa Malaysia and measures i.a. their level of compliance with the exchange's listing requirements and the Malaysian Code on Corporate Governance standards. The index, which is the first of its kind in the country, is designed to track and identify not only companies that comply with the disclosure standards and requirements and are fair and transparent to their stakeholders, but also companies that demonstrate strong financial performance.

The board's role guiding corporate strategy in Malaysia

As discussed earlier, the *Companies Act* clearly provides that the board is responsible for managing the affairs of the company and has powers to supervise the management of the business. Every director of a company must act in the best interest of the company, including nominee directors. The board should also apply ethical standards supported by a code of ethics. In this regard, Malaysia has firmer regulations than its regional peers such as Chinese Taipei, Indonesia, Korea or Thailand. In Malaysia, the Code of Ethics is issued by the Companies Commission, a statutory body. Though implementation is voluntary, it provides companies with a reference for developing better standards.

To encourage board members to devote sufficient time and energy to their work, governments can establish caps on the number of directorships any one person can hold. In Malaysia, an individual may hold no more than 10 directorships in public listed companies, and 15 directorships in non-listed companies (OECD, 2011). As stated in the OECD *Principles*, service on too many boards can interfere with the performance of board members. Companies may wish to consider whether multiple board memberships by the same person are compatible with effective board performance and disclose the information to shareholders.

The Corporate Governance Blueprint (2011) recommended limiting the number of listed company directorships held by an individual director to five. The Malaysian Code of Corporate Governance (2012) further suggested that boards set out expectations on the time commitment for their members and protocols for accepting new directorships. Directors should notify the chairman before accepting any new directorships and the notification should include an indication of time that will be spent on the new appointment.

Boards and members of board committees should have clear and broad authority to demand information that board members believe is relevant to their work. Bursa Malaysia has instituted specific rules stipulating the right of directors to have access to information that is necessary and reasonable to perform their duties. So long as the determination of "necessary and reasonable" rests with directors or is very liberally interpreted by courts and regulators, such a provision should help provide the kind of information access required for effective board performance (OECD, 2011).

Malaysian standards and procedures for timely, reliable and relevant disclosure

Disclosure and transparency are long established corporate principles in Malaysia and are stipulated in laws and regulations, including in the *Companies Act* and the *Financial Reporting Act* 1997. A continuous disclosure obligation on listed corporations is imposed by Chapter 9 of Bursa's listing requirements (Box 5.4), defined as the timely and accurate disclosure of all material information by a listed issuer to the public. Non-compliance with these requirements can result in the listed company and its officers being sanctioned by Bursa.

Box 5.4. **Bursa's disclosure requirements**

- corporate disclosure policy;
- preparation of announcements;
- immediate disclosure requirements;
- periodic disclosure requirements;
- circulars and other requirements; and
- disclosure requirements for specific listed issuers.

Source: Bursa Malaysia.

The *Companies Act* provides for certain disclosure requirements that must be satisfied by substantial shareholders of a company, including notifying in writing the company of his or her interest. Further, where there is a change in the interest of a substantial shareholder, the latter shall notify in writing the full particulars of the change, including the reason for which that change occurred. Where a person ceases to be a substantial shareholder in a company, he or she shall also notify the company and share a copy of the notice with the Securities Commission. The act also provides for the powers of the Court with respect to defaulting substantial shareholders.

In this regard, the Court may make various orders including to:

- restrain the substantial shareholder from disposing of any interest in shares of the company;
- restrain the exercise of any voting or other rights attached to any share in the company;
- direct the company not to make payment, or to defer making payment, of any sum due from the company in respect of any share in which the substantial shareholder has or has had an interest; and
- direct the sale of all or any of the shares in the company in which the substantial shareholder has or has had an interest.

It is also useful for the relevant regulators to issue guidance to supplement the mandatory requirements on disclosure. In Malaysia, this guidance aids listed companies to better understand and comply with disclosure obligations by clarifying and illustrating how the disclosure requirements should be applied in practice. The government has also taken advantage of international co-operation with authorities in the region to promote more effective disclosure and transparency. For example, Malaysia is a signatory to IOSCO's Multilateral Memorandum of Understanding, designed to facilitate cross-border enforcement and exchange of information among regulators. Nevertheless, while there is recognition that Malaysia has made significant strides in improving financial reporting and is converging with international best practices, challenges remain at the company level. For example, poor understanding of the merits of greater disclosure and of the significance of disclosure in enhancing value has been identified as a weakness of Malaysian companies, as well of many of their regional peers (OECD, 2011).

The SCM also noted in 2011 that companies "tend to adopt an approach whereby compliance with the CG Code is merely declared, with little or no explanation being provided on the extent of compliance" (SCM, 2011). Hence, companies are said to be following the minimum requirements, rather than using guidelines for improving their own governance standards. Listed companies are however required to report on their compliance with the CG Code in their annual reports, and the Code advocates adopting standards that go beyond the minimum prescribed by regulation (SCM, 2012).

Rights of stakeholders as established by law or through mutual agreements

As for the rights of stakeholders, case law has established that where the company is solvent, the interest of the company is synonymous with the interest of shareholders, but where the company is insolvent or near insolvency, the interest of the company is synonymous with that of creditors.

Furthermore, the Corporate Law Reform Committee has made numerous recommendations to reform corporate insolvency laws set out in *Company Liquidation: Restatement of the Law* and *Reviewing the Corporate Insolvency Regime: The Proposal for the Corporate Rehabilitation Framework* which recommends that the corporate insolvency regime for Malaysia should provide an option of subjecting a financially distressed company to judicial management. It also recommends that a Company Voluntary Arrangement which is modelled on the UK approach be added in the *Companies Act*. The arrangement offers a procedure for a financially distressed company to initiate a rehabilitation scheme by itself through the appointment of a qualified insolvency practitioner who will supervise the implementation of this scheme.

To further enhance creditors' rights, the Corporate Law Reform Committee also recommended abolishing any preference given in the winding up of a company to the government in respect of any unpaid taxes of a company under liquidation. The Committee recommended excluding "payment of gratuity for termination of employment" from the definition of "wages and salary of employees" in the *Companies Act* 1965.

As for the rights of employees in Malaysia, these are provided for under several pieces of legislation, including the *Employment Act* 1955 and *Industrial Relations Act* 1967. Further, Article 135 of the Federal Constitution provides for the right of an aggrieved civil servant to be given a reasonable opportunity to be heard.

Various initiatives have been undertaken to encourage companies to promote their reputational goodwill through investor relation and corporate social responsibility programmes (see Chapter 6 on Policies for promoting responsible business conduct. These include the establishment of the Malaysian Investor Relations Association and other bodies, which are described in more detail above.

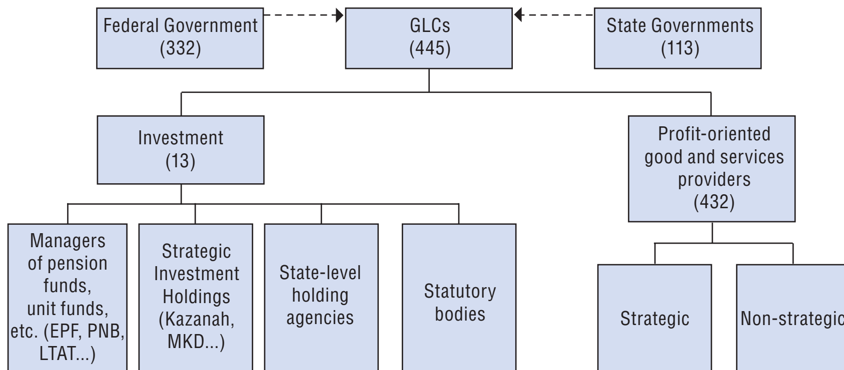
Governance of government-linked companies

In many economies, including in several OECD countries, state-owned or government-linked enterprises still represent a substantial part of GDP, employment and market capitalisation. They are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication, whose performance is of great importance to broad segments of the population and to other parts of the business sector. Consequently, the governance of GLCs is critical to ensure their positive contribution to a country's overall economic efficiency and competitiveness. OECD experience has shown that good corporate governance of GLCs is an important prerequisite for economically effective privatisation, since it will make the enterprises more attractive to prospective buyers and enhance their valuation (OECD, 2005).

The scale and scope of GLCs in many Asian economies calls for specific attention to be given to their corporate governance. Even if their economic significance varies greatly from country to country, they still represent a major, if not dominant, part of the economy in some countries (around 30% of GDP in China and 38% in Viet Nam). In Malaysia, GLCs are significant as they represent close to 15% of GDP, 5% of employment and 36% of the total market capitalisation, compared to 20% in Singapore and 25% in Thailand (OECD, 2011 and Putrajaya Committee on GLC High Performance, 2011 based on 2005 data).

The National Economic Advisory Council reveals that there are currently 445 GLCs in Malaysia, the majority owned by the federal government, and the others by state governments (Figure 5.2). The Council highlights difficulties in gathering a complete list of holdings and thus assumes that these figures are higher. As of February 2012, there were 35 listed GLCs in Malaysia.

Figure 5.2. **Government Linked Companies in Malaysia**



Source: Adapted from the National Economic Advisory Council (2010).

In the Malaysian economy, GLCs play a critical role through the provision of backbone services such as transport, energy, telecommunications, and financial services. Khazanah Nasional Bhd, the Employees Provident Fund, and Permodalan Nasional Bhd, a non-financial public enterprise managing unit trusts and property trusts for the *bumiputera* community, are some of the main government-linked investment companies (GLICs – see Box 2.4).

The government holds shares in public listed and unlisted companies through two bodies – the Minister of Finance (Incorporated) [MOF (Inc.)] and Khazanah. MOF (Inc.) was established as a corporation under the *Minister of Finance (Incorporation) Act* 1957, allowing MOF (Inc.) to hold, invest, acquire and dispose assets of every description including shares. Khazanah, a company formed under the *Companies Act* 1965, is wholly owned by MOF (Inc.) except one share held by the Federal Lands Commissioner. Khazanah's official role is

to promote economic growth and to make strategic investments on behalf of the government which would contribute towards nation-building. Some of the key listed companies in Khazanah's investment portfolio include Axiata Group, Telekom Malaysia, Tenaga Nasional, CIMB Group, Malaysia Airlines, Malaysia Airports and UEM Land (see Chapter 8 on Infrastructure development).

Companies held by Khazanah, most of which are listed, are governed by its Memorandum & Articles of Association, the *Companies Act*, and the Listing Requirements of Bursa Malaysia and the *Securities Commission Act*. The GLC Transformation Programme (Box 5.5) spearheaded by the Putrajaya Committee on GLC High Performance, also applies to companies held by Khazanah.

Box 5.5. **The GLC Transformation Programme**

Starting in 2004, Malaysia embarked upon a programme to transform the investee companies of its GLICs into high performing companies. The Transformation Programme for GLCs is part of a broader and long-term modernisation programme of the national economy, based on benchmarking of performance against the experience in other countries. The programme aims to be realistic, performance-focused and highlight governance issues and shareholder value. Implementing this reform programme is managed, tracked and monitored by the "Putrajaya Committee on GLC High Performance" – PCG, chaired by the Finance Minister, including representatives from all key GLCs. Khazanah serves as a secretariat for this committee.

The first phase (2004-2005) introduced key performance indicators (KPIs), performance-linked compensation, as well as changes in board and senior management composition. The work of the PCG culminated in a "Transformation Manual", which includes the overall policy guidelines of the PCG to address some of the core challenges facing GLCs.

In the second "Generate Momentum" phase (2005-2006), ten initiatives were identified for launch and implementation across all GLCs, with the development of in-house guidelines including enhancing board effectiveness, strengthening directors' capabilities, enhancing GLC monitoring, improving the regulatory environment, reviewing and revamping procurement, and intensifying performance management practices. This second stage provided a series of reference books, such as the Green Book on enhancing board effectiveness and revamping board practices and processes, the Silver Book, which clarifies social obligations, the Red Book to review and revamp procurement, the Yellow Book about enhancing operational effectiveness, the Purple Book on optimising capital management practices and the Orange Book on managing and developing human capital.

Box 5.5. **The GLC Transformation Programme** *(cont.)*

The GLC Transformation Programme has yielded positive results: Total shareholder return of the top 20 GLCs (the G20*) outperformed the rest of non-G20 FBMKLCI (FTSE Bursa Malaysia Kuala Lumpur Composite Index) by 0.8% per annum (p.a.) from 14 May 2004 to 18 May 2012, growing at 13.7% p.a. compared with non-G20 FBMKLCI at 12.9% p.a.. Market capitalisation of the G20 has more than doubled from RM 140 billion to RM 319 billion over the same period. G20 net income grew 18.2% p.a. from RM 9 billion in FY2004 to an all-time high of RM 20.1 billion in FY2011.

Source: PCG, 2010, GLC Transformation Programme Progress Review May 2012.

Government-linked corporations in Malaysia are not exempt from the application of general laws and regulations. As companies incorporated under the *Companies Act*, GLCs must comply with its provisions. Likewise, if a GLC is listed on the Exchange, it must comply with the listing requirements and observe all ongoing obligations of a listed company. In this regard GLCs do not benefit from preferential treatment in the Malaysian legislation.

Notwithstanding the encouraging and substantial achievements to date, more could be done to achieve the ultimate aspirations of the programme. Regular initiatives to keep up momentum are critical to avoid any risks of complacency given the long-term nature of the programme. Yet, while GLCs in general still underperform relative to top regional sector peers, some companies with substantial GLC equity interests, such as Axiata, CIMB, and Maybank, have emerged as regional champions in their sectors. The government's efforts to transform the GLCs to create economic and shareholder value have led to the Green Book for GLCs published in 2006 (Box 5.6). One major policy thrust of the Green Book is to upgrade the effectiveness and accountability of GLC boards, and to depoliticise GLCs.

Implementing the Green Book has resulted in significant progress in raising board effectiveness and in enhancing its composition: 83% of the G20 had completed their Board Effectiveness Assessment by 2008 and 67% had developed their Actionable Improvement Programme (OECD, 2011). GLCs have also played an important role in raising the profile of sustainability reporting in Malaysia through the Silver Book launched in 2006 (see Chapter 6 on Policies for promoting responsible business conduct).

As a result, many of the companies that have been ranked highly in terms of good governance practices are actually GLCs. During a survey conducted by the Malaysian Shareholders Watchdog Group for the *Corporate Governance Index* in 2009, 17 out of the 33 listed GLCs were ranked in the top 100 of the *Index* (covering 899 companies). During a survey conducted in 2011, 19 out of

Box 5.6. **Green Book on Enhancing Board Effectiveness in Malaysia**

A review by the Putrajaya Committee on GLC High Performance (PCG) in Malaysia found that the current pool of GLC directors was too small and resulted in some directors holding too many mandates. With the evolving strategic, operational and geographic priorities of GLCs, boards now require new types of expertise in marketing, organisational design and change management. While recognising that not every director will possess all necessary and relevant knowledge and experience, the objective is to ensure that on a collective basis, every board is balanced and reasonably complete in its pool of skills.

PCG recommends that GLICs and GLCs proactively leverage new sources from private sector organisations. GLC CEOs at the early stage of GLC transformation are not encouraged to sit on other boards, apart from the boards of their subsidiaries. Exemptions to this rule are given on a case-by-case basis. Additionally, in order to ensure that directors have the time to be effective board members, PCG recommends that the cap on the number of listed boards on which a director of a GLC can sit be limited to five. The Green Book, which had to be implemented by all GLCs by the end of 2006, aims to help GLC boards to upgrade their effectiveness. It includes the following recommendations where relevant in accordance with the Malaysian Code of Corporate Governance, and reinforced by the Bursa Securities Listing Requirements:

- GLCs have a Nomination Committee – consisting exclusively of non-executive directors, a majority of whom should be independent – to recommend to the board clear and appropriate criteria for directorships.
- At least one-third of the entire board, with preferably no more than 10 members, should be composed of independent directors (up to 2 members may be from management with a maximum of 30% representation).
- There should a clear and distinct separation between the roles of the chairperson and CEO reviewed at least every 2-3 years, to ensure a balance of power and authority, such that no individual has unfettered powers of decision. To reinforce the importance of the chairperson's position, the selection criteria for chairpersons are more stringent than for normal directors.

The Green Book also gives practical suggestions on how to raise board effectiveness. For example, it gives a description of the ideal characteristics of an effective director, in terms of knowledge, skills and mindset. Finally, the Green Book provides guidance on how to conduct an "Effectiveness Assessment" and to develop an "Actionable Development Programme".

Source: OECD (2010), *Policy Brief on State-Owned Enterprises in Asia – Recommendations for Reform.*

the 35 listed GLCs were ranked in the top 100, covering 820 companies listed on the Exchange as of 31 December 2010.

Despite these advances, the government should keep up its efforts reforming GLCs and reducing any crowding-out of private investment (see the Overview). The NEAC in the New Economic Model stresses this point strongly in view of rationalising the government's participation in business. It mentions that GLCs are perceived to have gone beyond their original functions of providing public goods and services and fuelling socioeconomic change through wealth-distribution and are now competing directly with business. A number of GLCs continue to underperform, as manifested through low economic profit figures and low share price developments (NEAC, 2010).

The NEAC has made a series of detailed recommendations to restructure the GLC landscape in Malaysia, including the need for an oversight mechanism for GLCs and for divesting non-strategic GLCs (Table 5.3), while exposing the remaining companies to high governance standards and competition. With regards to the oversight mechanism, the NEAC advises that the government form a GLC Oversight Authority, which could be embedded in the existing Putrajaya Committee (NEAC, 2010).

Table 5.3. **NEAC Proposed divestment strategies for non-strategic GLCs**

Category	High-performing unlisted companies	Unlisted low performers with turnaround potential	Unlisted low performers without turnaround potential
Strategy	Companies with good track records meeting Bursa Malaysia listing criteria to be divested via the capital market. Aggregate government shareholding capped at 10% of issued shares.	Appoint professional managers and provide incentives to revive the companies.	Using objective criteria to determine strike price offer to the private sector for sale, failing which: liquidate entities and establish an asset-management company to dispose of assets in a transparent and market-based manner.

Source: Adapted from National Economic Advisory Council.

The potential impact of GLC reform should not be underestimated. Improving GLCs' corporate governance could potentially lead to significant efficiency gains, improve the quality of public services, decrease the fiscal burden and public debt, and ultimately contribute to overall growth. Expected benefits can also include better valuation of state assets (for potential future privatisation). It will also, in many cases, improve overall public governance, including through greater transparency. Last but not least, it will ensure more effective competition with the private sector.

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From:

OECD Investment Policy Reviews: Malaysia 2013

Access the complete publication at:

https://doi.org/10.1787/9789264194588-en

Please cite this chapter as:

OECD (2013), “Corporate governance”, in *OECD Investment Policy Reviews: Malaysia 2013*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264194588-11-en

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