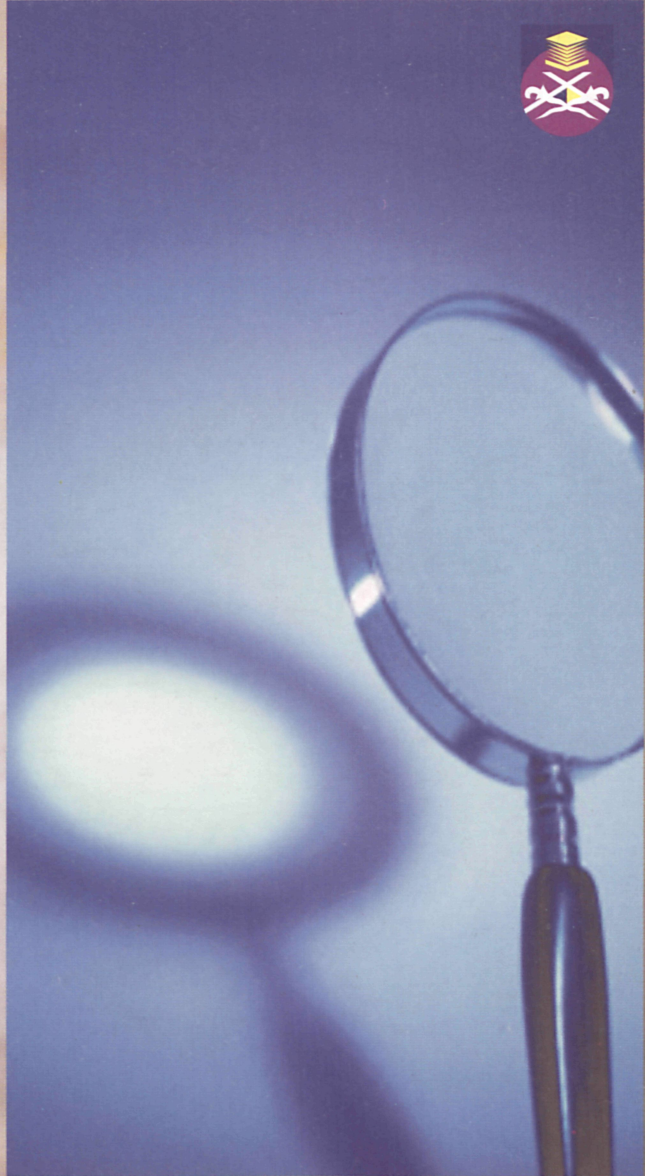


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HOW TO MAKE THE BOARD EFFECTIVE FOR GOOD PRACTICES OF CORPORATE GOVERNANCE

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In general, corporate governance is a system on how an enterprise is governed and controlled or the process and structure used to manage business and affairs of a company with accountability. It comprises the internal and external structure of the enterprise, management accountability of its authority and agency through an effective internal control system and legislation, and market control for disclosure of corporate information and transparency of the company's affairs.

INTRODUCTION

The issue and the development of Corporate Governance have become so popular in 1997 and 1998 when the Asian Financial crisis occurred. The weaknesses of many companies were exposed to the public during this period. Many corporations suffered financial losses or became bankrupt. The lack of good corporate governance contributed to the loss of investors' confidence in our companies. Therefore, in order to gain the investors' confidence it is important to have good corporate governance. Basically, if the country practices good corporate governance, the economic crisis will only have a small effect on the economy. It is said that better macro economic policies and better regulation for corporate governance, will reduce the possibility of corporations to act irresponsibly.

THE DEVELOPMENT OF CORPORATE GOVERNANCE IN MALAYSIA

Corporate governance in Malaysia actually stretches way back to 1898. However, the real stimulus to the development of corporate governance in Malaysia was the Asian financial crisis in 1997 until 1998. The Asian financial crisis revealed lax standards of corporate governance in countries like Malaysia. This was exacerbated by the fact that Malaysia was viewed in the same basket with its regional neighbors like Thailand, Indonesia, South Korea and Philippines.

The needs for better corporate governance is also boosted by fast growing markets and the move towards 'borderless' world or normally referred to as globalization. This is because Malaysia will have to comply with the obligations of the World Trade Organization (WTO), as Malaysia is a signatory to the agreement. Investors are now increasingly demanding for more information, so that they can make the required informed decision. This is due to the transactions undertaken by corporations becoming increasingly more complex, accounting standards and regulatory requirements are increasingly structured to promote greater transparency. Hence, investors would per-

ceive negatively those companies that are reluctant to make such information readily accessible (PWC, 1999).

Initiatives at raising the level of corporate governance in Malaysia begins with a move that was taken in March 1998 when a High Level Committee was established to look into recommending measures to enhance corporate governance (Jassel, 2000). The committee comprised Government officials, regulatory authorities, industry organizations and representatives from the corporate sector. Then, they came up with the Malaysian Code on Corporate Governance, laying down seventy recommendations for public-listed companies to follow.

In today's economic conditions, it is crucial for Malaysian organizations to adhere to high corporate governance standards in order to survive. The uplifting of local corporate governance standards will contribute towards the restoration of foreign and local investors' confidence. This has also been highlighted by the Malaysian Finance Minister in his 2001 Budget speech. He stressed that good corporate governance is necessary in order to bring greater transparency and accountability to meet the 2001 Budget's aim, which is to strengthen financial services and the capital market. Since foreign direct investment (FDI) has been identified as the main factor to broaden the domestic market and move towards globalization, Malaysia has to encourage more FDI (NST, 2000). Therefore, the existence of more accountable, transparent and greater disclosure is a prerequisite to restore investors' confidence in order to attract more FDI to the country.

Bad practices and abuse of power in some companies had indeed caused company shares to plunge and the whole stock market to tumble, particularly in 1997. They had affected investors' confidence, and that is always hard to regain. The landmark example of the bad corporate governance in Malaysia is the case of Perwaja Steel, whereby the company's funds were transferred to fictitious companies by its top managers. Another disappointing fact about company's directors is that, according to a survey conducted by Kuala Lumpur Stock Exchange (KLSE) and PricewaterhouseCoopers, only 11 percent of directors know about their responsibilities and duty in internal control (PWC, 1999). Hence, the formation of high-level government-sponsored Finance Committee and Corporate Governance, the publication of the Report on Corporate Governance, and the recent formation of the Malaysian Institute of Corporate Governance (MICG) by six organizations, indicate the importance attached to corporate governance by the authorities in order to curb such abuses (Ho, 1999).

ACCOUNTABILITY, TRANSPARENCY AND DISCLOSURE

The corporate governance is mainly about accountability and transparency. It is about how the board and management entrusted with the conduct of a company's affairs are held accountable to its shareholders and stakeholders, and the board control mechanisms that should be put in place to underpin accountability.

Based on the Report on Corporate Governance, among others, the revamped listing rules will expand and clarify the definition of independent directors. It will also seek to make it mandatory for public-limited companies to ensure that at least two directors or one third of its board mem-

(whichever is higher) are independent.

Corporate governance is also about how the enterprise presents itself transparently to the world outside the organization, namely to shareholders, potential investors, employees, regulators and other interest groups with a legitimate interest in its affairs. Therefore, to enhance greater transparency, the new rules will also relate to corporate disclosure by making clear the standards of disclosure expected from public-listed companies.

Disclosure is about internal stewardship and control, and the emphasis on the company's approach to promote the development of the best practices on corporate governance. Thus, improvement in disclosure by the revamped listing rules is to require companies to make the necessary disclosures in their annual reports in respect of their compliance with the Code on Corporate Governance (Jassel, 2000).

APPROACHES TO GOOD CORPORATE GOVERNANCE

Obviously, there is a paradigm shift in the approaches to good corporate governance over time. The initial stage was dominated by shareholders' approach, whereby company managers' duty is to maximize shareholders' wealth by maximizing the profitability and sales. Therefore, if the goal is purely monetary, then the temptation is to resort to illegal or unethical devices.

On the other hand, there is also a shift towards ethics approach. This approach is associated with the fact that enterprises exist in the middle of a community. Apart from their obligations to shareholders, the managers must realize that they should also look at their role and responsibility towards the stakeholders or the community as a whole. More specifically, the enterprises are also responsible to their employees, suppliers, customers, government, environment and the community where they are located in. In the case of the relationship between the companies and their environment, they should be concerned with environmental issues, be willing to spend for enhancing and maintaining the environment, and more importantly they should operate within environmental laws and regulations. Therefore, for instance, a perfume company should not produce perfume containing gases such as chlorofluorocarbon (CFC) that can contribute to the depletion of ozone layer, while a food-manufacturing company should use bio-degradable materials in its packaging process. A chemical company also should not dispose toxic wastes to rivers or sea, and so forth.

In other words, for corporate governance to be effective, it has to be a way of corporate life and should be placed in the context of corporate practices on social responsibility and environmental practices, apart from merely focusing on profitability alone.

MALAYSIAN CODE ON CORPORATE GOVERNANCE

Malaysia has adopted Hampel approach in setting up the Code as it is considered the most suitable approach for the Malaysian environment. The impact of the Code in raising standards of corporate governance can be seen from the experiences of other jurisdictions. To quote the Hampel Committee:

"...it is generally accepted that implementation of the Code's (Cadbury Code of Best Practice) provisions has led to higher standards of governance and greater awareness of their importance....it is clear that Greenbury's primary aim – full disclosure – is being achieved."

The Cadbury Committee's report on compliance showed that significant changes had taken place in the structure of UK board in line with the committee's recommendations (however, the question arises on how far these structural changes were translated into changes in the working of the board, or in other words, are these changes more of form than of substance?) The awareness and attention generated by the Cadbury report has been phenomenal. The report has struck a chord internationally, and it has provided a yardstick against which standards of corporate governance are being measured. Therefore, Malaysia has adopted it, hoping that it can be implemented to bring a change in Malaysian business scenario (Report on CG, 1999).

The rules set out in Malaysian Code on Corporate Governance are merely voluntary. Hence, the relevant authorities such as Securities Commission (SC) and KLSE have sought to incorporate the most important of these recommendations into their rules and regulations. The amendments are aimed at strengthening provisions in the areas of disclosure, financial reporting and other continuing obligations, mainly following the Code's recommendations. However, having rules alone does not ensure that standards will be raised. Enforcement is the key to make sure that it works. Some analysts say that 'Malaysia is a country with many rules and regulations but the problem is these are not enforced sufficiently'.

Nevertheless, recent efforts show the authorities have stepped up enforcement. The Security Commission has taken some thirty people to court for various offences relating to corporate governance (Jassel, 2000). But while vigilant enforcement will ensure greater investor protection, companies should realize their role in enhancing investor confidence. The authorities have to bring a change in corporate culture. They need to cultivate the idea for the companies to voluntarily adopt the best practices in corporate governance and not merely because the authorities say so. In other words, self-regulations are required for long-term improvement in corporate governance and towards an effective implementation of corporate governance. Otherwise, it would be like "fire-fighting" process whereby 'the fire extinguisher is used when there is a fire; otherwise, it is left aside idle'. If only the requirement of law is considered, the directors will act just to satisfy the legal requirement, and have no initiatives to move beyond that. In this case, the objective of corporate governance is not fully achieved.

STATUTORY REGULATION VERSUS SELF-REGULATION

The Committee has to consider to what extent reforms may be necessary in addressing appropriate balance and content of regulation. This is because corporate governance come in two aspects, one where statutory regulation is necessary and effective and another where self-regulation is more appropriate.

For example, the responsibilities of directors, officers and other corporate participants should be

legally defined. The law should clarify their duties, so that they are readily understood by them and other corporate participants. However, the process or system of governance is harder to capture in legal terms. Some issues related to composition and workings of board are difficult to legislate. For example:

- The presence of independent elements on the board.
- The use of board committee and relationship with management.
- Training of directors, and
- How board should appraise their own performance.

Hence, the aim of the Code is to encourage disclosure and the provision of information to investors about board composition and structures, in order that investors can monitor the way the companies to which they have entrusted their funds are being run. Such a provision also affords companies a certain amount of flexibility in implementing the provision of the Code.

CONCLUSION

The general consensus is that corporate governance can be the pillar through which Malaysia (and other Asian nations as well) are going to fully recover from the onslaught of the recent financial crisis. However, the implementation process of these recommendations may take sometime to bear fruit, considering the Malaysian business culture and environment.

Undoubtedly, corporate governance and other government macro economic policies have the potential to control the surrounding in which business is contracted, which means including the community and the environment as a whole. They also have the potential to curb the irresponsible wrongdoings by directors with proper enforcement. However, the modern corporate enterprise also needs self-regulation practices for long-term survival, with the hope that this will totally change the business world especially in Malaysia. Self-regulation practices are more important than statutory code because they determine which boards work within it and the quality of people who make it work. The structural changes also should be translated into changes in the working of the board, to ensure that the changes are more on the substance rather than in its form. In this complex and rapidly changing world, everything cannot be incorporated in law. Of course this limitation can be overcome by strengthening the courts and judiciary, but one cannot run 200 trains with 50 drivers and 100 guards! (Kanapathy, 2000). In other words, if it is true that 'the buck stops at the board for bad corporate governance', thus, to improve the corporate governance must begin with improving the board first.

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