The History Of Corporate Governance And Control In Malaysia

Khairul Anuar Kamarudin & Wan Adibah Wan Ismail
Faculty of Accountancy, UiTM Kedah

Corresponding author: khair652@kedah.uitm.edu.my

Attention to corporate governance has emerged in Malaysia since the introduction of the Companies Act 1965 and was subject to progressive development long before the 1997 economic crisis. The 1965 Act describes the roles and responsibilities of directors and managers to keep proper accounting records (Abdullah & Mohd Nasir, 2004). Subsequently, the Securities Industries Act (SIA) 1983 and the Securities Commission Act (SCA) 1993 provided a legislative and regulatory framework for the Malaysian capital market. These last two Acts prohibited artificial trading and market rigging, thereby effectively regulating the operations of securities dealers (Liew, 2007).

The Securities Commission was established in March 1993 as a watchdog to improve the legal and regulatory framework governing the capital market. In the same year, the Bursa Malaysia Listing Requirements were revised to require all listed firms to set up audit committees of at least three people, comprising a majority of independent directors. This requirement was intended to improve the standards of corporate disclosure in Malaysia (Wan Hussin & Ibrahim, 2003).

To enhance the accountability of directors and to promote good corporate ethics, the Companies Commission of Malaysia, formerly known as the Registrar of Companies, introduced the Code of Ethics for Directors in 1996. In the same year, the Securities Commission moved from a merit-based system to disclosure-based regulation, which ensured high-quality financial reporting by promoting improved standards of disclosure, due diligence, corporate governance and accountability among the directors of public firms. Under the new system, the role of the Securities Commission shifted from evaluating the relative merits of the issuer and its securities to regulating the disclosure of quality information (Che Haat, 2006). The final implementation phase of disclosure-based regulation would require all listed firms, among other requirements, to: (1) publish financial statements on a quarterly basis within two months of each financial quarter (these statements include an income statement, a balance sheet, a cash flow statement and explanatory notes); (2) furnish annual audited accounts, and auditors’ and directors’ reports within four months from the end of the financial year; and (3) make immediate public disclosure of all material information of a financial and non-financial nature concerning its affairs (Nathan, Lin, & Fong, 2000).

The Asian economic crisis began in July 1997. The value of the Malaysian currency, Ringgit Malaysia (MYR), dropped from MYR 2.50 per USD to, at one point, MYR 4.80 per USD. The Bursa
Malaysia composite index fell from approximately 1300 to nearly 400 points in a few short weeks. Interest rates increased to more than 12% during the crisis. These problems started with the speculative short-selling of Malaysian currency, which was followed by high capital outflows from the country. In December 1997, to control these problems, the Malaysian government imposed capital controls including pegging the Malaysian Ringgit at 3.80 to the US dollar. Other measures included restricting the trading of Malaysian stocks outside Malaysia, introducing a punitive tax for holding Malaysian stocks for less than one year and making unofficial trading of the ringgit illegal.

The financial crisis also caused a massive loss of foreign investors’ confidence in the Malaysian capital market, and this was exacerbated by poor corporate governance. Rajan and Zingales (1998) argue that investors ignored weaknesses in East Asian firms when the economy was doing well, but quickly pulled out once the crisis began because they believed the region lacked adequate institutional protection for their investments. Furthermore, expropriation of minority shareholders became worse during that period. In addition, Johnson, Boone, Breach, and Friedman (2000) argue that in countries with weak corporate governance, the financial crisis resulted in more expropriation of wealth by managers, and thus caused a larger fall in asset prices.

United Engineers Malaysia (UEM), a blue chip firm in Malaysia, provides an example of the expropriation of minority shareholders interests during the financial crisis. In November 1997, UEM acquired 32.6% of Renong, its financially troubled parent. The minority shareholders were horrified and saw this transaction as a bailout of Renong at an inflated price. UEM’s stock price fell 38.24% on the day the transaction was announced (Foon, 1997, p. 62). The controversy surrounding this transaction, which was undertaken without proper disclosure and prior shareholder approval, led to a significant loss in investors’ confidence in the Malaysian stock market (Abdul Rahman, 2006).

The impact of the financial crisis, in particular the reduced investors’ confidence in the Malaysian capital market, provided a strong impetus for regulators to introduce reforms to enhance the protection of investors. The reforms targeted two main areas: corporate governance and financial reporting. Corporate governance reforms, among others, are crucial to: (1) strengthening the protection of minority shareholders’ rights; (2) enhancing the transparency and accountability of directors; (3) strengthening regulatory enforcement; and (4) promoting training and education at all levels in corporations.

The reforms started with the establishment of the High Level Finance Committee on Corporate Governance by the Ministry of Finance in March 1998, followed by a series of regulatory changes through the Securities Commission, Bursa Malaysia, and the Companies Commission of Malaysia. This included the establishment of the Malaysian Institute of Corporate Governance, and the Minority Shareholder Watchdog Committee.

The High Level Finance Committee on Corporate Governance, comprising government and industry representatives, carried out detailed investigations to identify and address weaknesses relating to the 1997 financial crisis. Bursa Malaysia and PriceWaterhouseCoopers (PWC), on the
other hand, conducted a survey on corporate governance of public listed firms and then made recommendations for corporate governance best practices in Malaysia. The result was the Report on Corporate Governance, 1999, which highlighted the importance of boards of directors as corporate governance mechanisms to protect and enhance shareholders’ wealth. The report aimed to improve corporate disclosure, promote good corporate governance practices in Malaysia, and to re-establish investors’ confidence in the Malaysian capital market (Finance Committee on Corporate Governance, 1999). Following the recommendations proposed by the Finance Committee on Corporate Governance (FCCG), the High Level Finance Committee on Corporate Governance introduced the Malaysian Code on Corporate Governance (MCCG) in March 2000.

References


