

CORPORATE GOVERNANCE IN MALAYSIA: THE EFFECT ON STATE BUSINESS RELATION

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ABSTRACT

The Asian Financial Crisis in 1997 not only introduced the corporate governance term but also drew an attention to the public about the weaknesses of Malaysian corporate governance practice. After 1998, Malaysian government decided to adopt corporate reform that could enhance the quality of good corporate management practice. This reform is clearly stated in the code and rules of corporate governance. The purpose of this research is to study the significance of implementing the code and rules of corporate governance since public already realize the close relationship between business and politics. Three companies were chosen as indicators for this study. As a result, it is found that companies, which involve in corporate malpractice but have good relationship with states will always be excluded from the legal corporate action.

Keywords: Corporate Governance, Political Economy, State Business Relation

INTRODUCTION

Asian Financial Crisis in 1997 not only introduced the corporate governance term but also drew an attention to the public about the weaknesses of Malaysian corporate governance practice. After 1998, Malaysian government decided to adopt corporate reform that could enhance the quality of good corporate management practice. This included the introduction of new Malaysian code and rules for corporate governance. The issues were widely debated especially by those agencies whose directly involved in the law enforcement such as Ministry of Finance, Kuala Lumpur Stock Exchange (KLSE)¹⁸, Securities Commission (SC) and Registrar of Company.

However, the aim of this paper is to study the significance of the implementation of the code and rules of corporate governance from political economy perspective. In Malaysia, the close relationship between the business and politics is no longer a secret (Gomez, 1990 & 1994). There are a few firms wholly owned and controlled by the ruling parties. This phenomena lead to a question whether these companies will face any legal corporate action should they failed to comply with any of the code and rules set under the corporate governance.

RESEARCH METODOLOGY

This paper used qualitative research methodology which is conducted based on the secondary resources. Further analyses were carried out using the Basic 'Black Box' Model of Corporation, by Blair (1995) which explained on how the elements of the corporate governance are functioning. This research attempts to answer the following hypothesis:

"Companies, which have good relationship with states will always excluded from penalty under the rules and code of corporate governance".

THE CONCEPT OF CORPORATE GOVERNANCE

The phrase 'corporate governance' is oft used but yet lacks a precise definition (Low, 2000: 436). Most of the definitions focus on the structure and the function of the board of directors or the rights and prerogatives of any shareholders in boardroom decision making. The High Level Finance Committee Report¹⁹ on Corporate Governance in Malaysia also defined corporate governance from that perspective. They defined corporate governance as "the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value whilst taking into account the interest of other stakeholders" (Lee, 2000:41).

¹⁸ Recently known as Bursa Malaysia

¹⁹ The committee comprise the Ministry of Finance, the SC, the Companies Commission of Malaysia, the Financial Reporting Foundation, The Malaysian Accounting Standards Boards, Bank Negara Malaysia, Association of Bank Malaysia, The Association of Merchant Banks Malaysia, KLSE, The Association of Stock Broking Companies Malaysia, The Malaysian Association of the Institute of Chartered Secretaries and Administration and the Federation of Public Listed Companies

From the definition, corporate governance mainly focuses on the process used to direct and manage the business and affairs of the company with the objectives of striking balance on:

1. The attainment of the company's objectives;
2. The alignment of corporate behavior to meet the expectations of shareholders; and
3. Accountability and good stewardship, taking into consideration the interests of shareholders, stakeholders, corporate participants and society at large

Thus, corporate governance can be described as the proper procedure on how the 'government' of a company (the managers and board of directors), should be responsible to their 'voters' (the shareholders, creditors and investors). Corporate governance emphasized on the transparency of decision making process, fairness and trustworthy in managing a company.

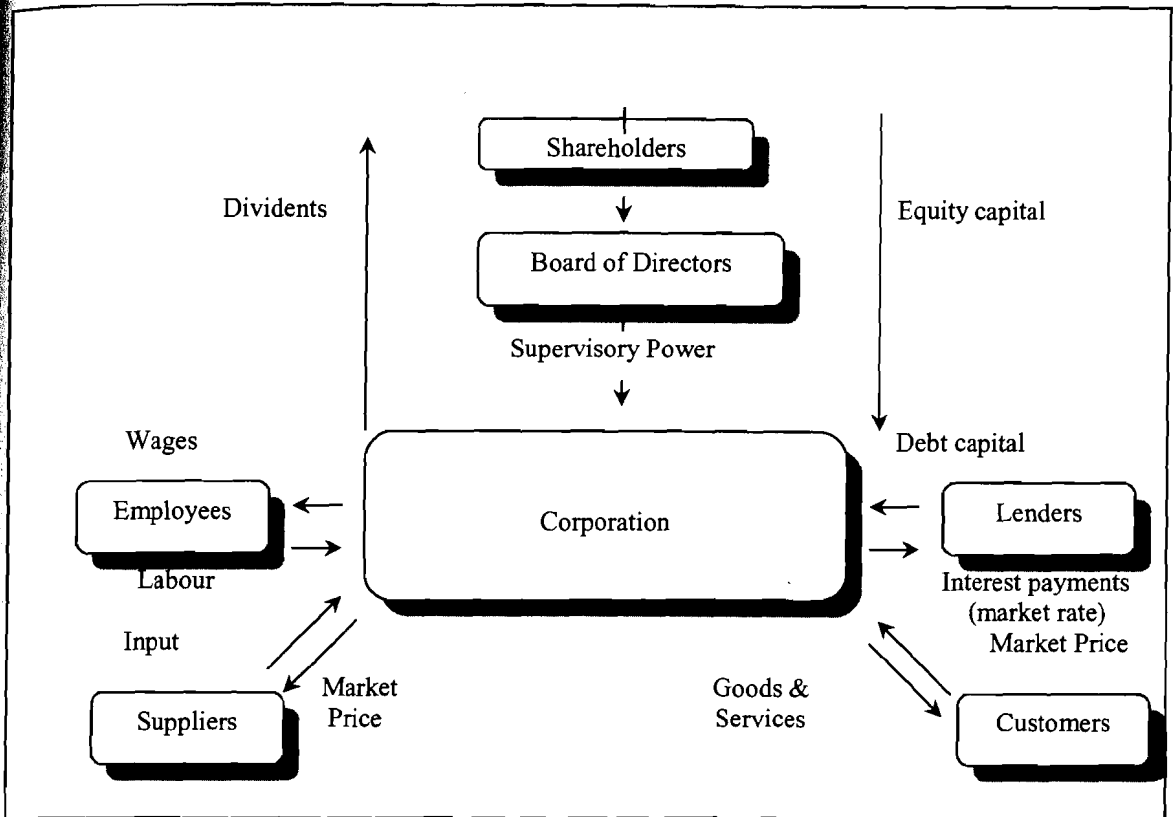
However, Blair (1995) viewed the definition and concept of corporate governance from a wider perspective but at the same time still emphasize on the ownership and control element as suggested by Cadbury (1992), Monks and Minow (1995)²⁰ and The High Level Finance Committee Report. For Blair, the degree of good enforcement of corporate governance very much depends on the roles of the state.

THEORITICAL MODEL

Figure 1 illustrates the basic model of corporation. Corporations are organized and run by entrepreneur or a management team that raises funds to acquire physical capital and to finance initial operation by borrowing from banks and other lenders (debts) or by issuing and selling "equity" shares. The decision made in the board's room will give a direct effect to the shareholders and financial institution and indirectly affected the employees, suppliers and customers. The board of directors has the responsibility of making the right decision that should benefit directly or indirectly to all involved parties. Meanwhile, the ownership and control theory is important in order to ensure the company practices the check and balance system between the owner and the company's management. The owner of the company or the shareholders have the rights to obtain the accurate and correct information which enable them to be comfortable with the company's operation and be sure on return of their investment. They also have the rights to offer their opinion and suggestion to the company's management in improving certain actions that need to be taken by the company's management, or object upon any decision, which they believe as inappropriate or unprofitable to the company. The directors of the companies have to prove their abilities in making the right decisions especially decision related to investment and loan in order to preserve the interest of shareholders and other stakeholders.

²⁰ Ownership and control principle is to establish an internal management system in a company to avoid misuse of resources and fraud. The boards of directors and shareholders of company play an important role in determining the company's direction. At the same time, the balance of interest of all individual, company and society were done to encourage and develop investment opportunities, which benefit all parties involved. See Nor Azizah (2004: 32-37)

Figure 1: Basic 'Black Box' Model of Corporation Model



Source: Blair (1995: 21)

Eventhough the corporate governance recognized the rights and power of the shareholders and director as the shareholder's proxy, the rights and power are still subjected to the law regulated by the government (Blair, 1995). This means that the actual rights and power of the principal and its agent in the company's management is very much dependent on how much the state intervenes in the economy. In this case, Blair concluded that the state is the actual company controller compared to policy or law regulated under the rules and code of corporate governance. Financial institutions also play an important role in the enforcement of the corporate governance. The stability of the financial institution will also lead to company's stability. However, the problem arises when the financial institution is also owned by the state. As the owner, the state is able to control the company through the financial policy besides the rules and corporate laws.

RESEARCH ANALYSYS

Since 1998, government and private sector had chosen to enhance the corporate law in order to improve the level of corporate governance in the country. In 1999, under the Ministry of Finance, a High Level of Financial Committee on Malaysia Corporate Governance was formed. The committee was responsible to review the corporate framework and make recommendations to improve the level of corporate governance of the country. The committee felt that there were serious corporate governance weaknesses particularly in the following areas – transparency and disclosure requirement, corporate monitoring responsibilities and accountability of company directors including the rights of minority shareholders (Das, 2000:19). Therefore, the code of corporate governance, which includes the principles and best practices in the corporate governance, were established for the corporate participants. This code essentially aims to encourage transparency management of a company besides providing relevant information to the investors to enable them to guide the company's direction. This code can also serve as guidelines to the board of directors on how to manage the company based on their roles and responsibilities (Low, 2000:438).

The Bursa Malaysia and SC had gazetted new rules for the public listed companies. They were required to disclose their financial status, shareholders structure and loan position on a quarterly basis. The company's manager is subjected to penalty or sentence to jail if they fail to comply with the rules. The government had

grant a warrant amounting to US\$100,000 to MICG²¹ to conduct research and training program in order to improve the corporate governance standard and quality (Das, 2000: 19).

In August 2000, Minority Shareholder Watchdog Group was established to encourage the company to comply with the principles of corporate governance and to improve the awareness among the minority shareholder about their rights and the right methods to enforce their rights. Members of this committee were from the government fund institutions such as Employees Provident Funds (EPF), Armed Forces Fund Authority (LTAT), Pilgrims Fund Board (LUTH), Social Security Organization (SOCSO) and Permodalan Nasional Berhad (PNB) (Berita Harian 24/05/2001).

The undertaken reformation illustrated that the government and the private sector had put much effort in order to enhance the standard of Malaysian corporate management. An investment bank, CLSA Emerging Market in collaboration with Asian Corporate Governance Association (ACGA) through their research regarding the Asian Corporate Governance, reported that Malaysia had achieved the highest score of 9.0 compared to other Asian's countries in reforming their corporate rules and regulation (Malaysian Business, 16/07/2003). However, the same research also showed that score for the enforcement of corporate rules and regulation was among the lowest (refer to Table 1). With a score of only 3.5, Malaysia was ranked 4th lowest position after Indonesia, Philippine and Thailand. This scenario tells us that the law reforms and implementation are inconsistent.

Table 1: Rank of Countries based on Corporate Governance

Singapore	8.5	7.5
Hong Kong	8.0	6.5
India	8.0	6.0
Taiwan	7.0	5.0
Korea	7.0	3.5
Malaysia	9.0	3.5
Thailand	7.5	3.0
China	5.0	4.0
Philippine	6.5	2.0
Indonesia	4.5	1.5

Source: Amended from Malaysian Business, 16/7/2003

According to Blair, the corporate governance enforcement is very much dependent on how much the state intervenes in the economy. If the degree of intervention is high, thus it will lead to a conflict of interest in the roles of state, which later will influence the level of enforcement of the rules and laws. In Malaysia, it can be seen that the state intervention in the economy began in 1970 when the government initiated the positive discrimination policy i.e. the New Economic Policy (NEP).²² Under the NEP, government tries to groom *Bumiputera* entrepreneur groups in modern economic sector. Therefore, the trustee system²³ was created to

²¹ Malaysia Institute of Corporate Governance

²² NEP was introduced with an objective to obtain national integration through poverty elimination and society restructuring to eliminate economic trademark by race.

²³ The trusteeship system is referred to trusted individual or organization in implementing certain policy. According to Jomo et.al (1986:5), there are two basic criteria in trustee strategy in Malaysia. Firstly, decision on budget allocation and resources and preferred investment were done according to rules and method determine by the trustee. Secondly, the power on economic resources is with the trustee and separated from the parties who owned it. There are two level of trusteeship. The first level is that small group of individuals who makes political decision. The second level is those superior officers and government servants who serve as the middleman in implementing and controlling multiples projects and programs under the trustee system. Under the system, the level of poverty or wealth is very much dependent on decision made by the trustee and how the decision is derived. If the decision make were done with efficiency and fairness, a proper production and distribution can be obtained effectively compared to capitalism system and socialism system. See Gomez (1990); Nor Azizah (2004).

achieve NEP's overall mission. Public enterprise was among the first method introduced by the government to increase *Bumiputera* participation in commercial trading sector. However, this method has actually initiated the relationship between business and politics. Initially, the state involves as the shareholder for the *Bumiputera*, and then takes a step further by becoming the company owner or shareholders or as an investment proxy through companies owned by the ruling parties.

Three companies were selected as indicators for this research. They are Perwaja Steel Sendirian Berhad (Perwaja), Renong Berhad (Renong) and Malaysian Airlines System Berhad (MAS). Perwaja was established in 1982 by HICOM Berhad, a wholly owned company of the government in collaboration with Nippon Steel Corporation, a company from Japan, in conjunction with the government's mission in implementing the heavy industrial policy. This is an example where the government has direct interest, as their shareholders. In corporate sector, Renong²⁴ is known as UMNO's²⁵ investment companies. Renong is a successful conglomerate after Halim Saat²⁶, Daim's protégé took over its management. Since Halim overtook Renong, he really helps UMNO move in business (The Star 25/3/1991). Renong being awarded by many infrastructure development contracts from the state.²⁷ MAS' establishment and ownership is also related to state. MAS started as an airline company wholly owned by the government but later on sold to Bank Negara as a private entity. However, despite the transfer of ownership, the government still owned the 'golden share', which comes with the veto power for the government to influence MAS decision making process. In 1993, Bank Negara had sold MAS to Naluri Berhad. Likewise Renong, Tajudin Ramli, Naluri's owner was also Daim's protégé. The veto power of the government remained unchanged.

The state ownership in those three companies creates close relationship between business and politics. According to Gomez (1990), this relationship can no longer split the business and politics as two different entities, but make them indispensable and dependable to each other.²⁸ In researcher point of view, this relationship can easily caused fraud and corruption in the trustee system and offer much freedom to the businessman to act beyond the corporate law.

Since incorporated, Perwaja had never gain any profit but rather full with never ending scandals and corruption issues.²⁹ Based on the audit report, Perwaja was not only insolvent but also faced with corruption and management problem in tenders and contracts awarding. For example, the Mah Sun Company and its related companies were awarded with RM967 billions worth of contracts without any authorization from the board of directors. Another RM103 billions worth of contract were also awarded to the same company with no documents being traced. Furthermore, doubtful trading transactions and payments were done to non-existence company i.e. Frilsham Enterprise.³⁰ But, no legal actions were taken against Perwaja until Eric Chia being arrested in Mac 2004. Today, Perwaja is still operating as usual with supports from the government.

The problems happen in Renong also reveal the malpractice of corporate governance. The Asian Financial Crisis affected Renong due to Ringgit depreciation, which leads to serious financial problem and increased the amount of accumulated Renong's debts between RM20-28 billions which constituted more than 5 percent of loans by Malaysian banking systems (AWSJ 12/10/1998; Gomez, 2002: 102; Thomas, 2002: 154). Many economists were puzzle with this situation. The main issue is how could the company obtain such a large fund as their corporate loans? Did their board of directors and shareholders perform their function responsibilities in making such a big decision? Is the loan process and procedure was simplified to enable Renong to obtain such a big amount? According to Gomez (2002), that figures indicated that a significant of bank loans had been channeled to a selected minority. During the crisis, Halim, who owned not exceeding 78% of personal interest in the company tried to save it via restructuring process. He used his subsidiaries to pay Renong's debt³¹ but the

²⁴ It started when Renong (after took over by Halim Saat) bought all Fleet Group assets from Fleet Holding (UMNO's investment company – refer The Star 27/3/1991) via reverse takeover with RM1.226 billion shares issuance. Halim Saat had admitted that he is an UMNO proxy in the business. See Gomez, 1994: 117.

²⁵ United Malays National Organization

²⁶ Halim Saat was the director for several governments owned companies i.e Landmark Holdings and Paremba. He was also the director for several listed public companies where Daim's (the current Ministry of Finance at the time) family member were among the shareholders i.e Roxy, D&C Bank and Clod Storage (Gomez, 1990: 49-50)

²⁷ See Gomez & Jomo, 1999: 97-98.

²⁸ Businessman needs politicians support for ease of being awarded with resources owned by the government. While politicians need businessmen support to fund their political campaigns during the election season to enable them to be reelected as representative in the government.

²⁹ In 1986, Perwaja reported a loss exceeding RM131 million, due to internal management problems and currencies movement as a result of economic crisis, where Japanese Yen appreciated against Ringgit Malaysia. See Financial Times 1/4/2002

³⁰ See Nor Azizah (2004)

³¹ Halim bought Renong's shares via UEM, while PLUS issued RM17 billion of bonds at coupon rate of not less than 10% per annum, in order to settle Renong's debt amounting to RM8 billion in 7 years. See Far Eastern Economic Review 24/4/2003

minority shareholders did not please his act as it is against their rights and interest and was a felony under the corporate governance rules.³² Majority analyzers were in view that this type of funding is ridiculous, as subsidiaries fund was not suppose to be used to bail out its parent's debt.

MAS also faced its internal management problems. Prior to the Asian Financial Crisis, MAS had already suffered with huge debts amount caused by the new management by Tajudin Ramli. This had put MAS at risk during the crisis as all their transactions were done in US dollar. At the same time, Tajudin also had huge personal debts.³³ However, the veto power of the government in MAS's management limit the plan for MAS expansion and funding strategies for its debts, i.e. decision on airlines destinations were subjected to government decision and endorsement. Sometimes, the destinations decided by the government were not popular destinations or less concentrated areas, but MAS has to oblige and extend its services to Malaysia foreign policy. This type of veto decision contributed to lower return on MAS compared to other airlines. Consequently, the Asian Financial Crisis affected both MAS and Tajudin badly due to the amount of debts being increased significantly. MAS had sold nine of their aircrafts costing to RM10 billions at a price of RM14 billions to pay Tajudin's personal debts (Massa 17/4/1999). As at December 1999, Naluri's loans were at RM888.25 billions causing the company being disqualified to be in charge of MAS operation anymore (Business Times, 21/12/2000).

At this point, we can see that the states involvement in business has changed and therefore increased the roles of state in many different ways. First, the state at its capacity as the shareholders has the rights to be informed about the business operation and plan of the company. They can accept or reject upon any proposals and plans as well as instructing the management of the company to pursue according to government's needs. Second, the state as the owner of the financial institutions³⁴ controlled the financial institutions that provide funds and working capitals. Third, the state as a ruler, can instruct any agencies and government offices to process applications for contracts, loan tender, etc from its wholly owned companies. The state at ruler's capacity is also the enforcer to any rules and legislation gazette by the government.

These roles, which are conflicting with each other, had made the appropriate ownership and control practice interrupted. This situation leads to an imbalance condition between the owner and controller of the company, perhaps had caused the misuse of government and financial institutions when the 'check and balance' system was neglected.³⁵

CONCLUSION

Even though the Asian Financial Crisis was over and we had successfully overcome the situation, we can never let it happen again as this crisis will lead to a great loss of our resources in longer term. We learn from the history that government's intervention in economic is essential as free market failed to build up the conducive economic environment. However, the degree of the government's intervention should be limited to certain extend, or else it could jeopardize the level of democratic practice by the key market players. The politics and business interest should be aligned in order to prevent any corporate misconduct hence avoiding selected legal phenomena, which affects government credibility as the ruler.

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³² In November 1997, Halim sold 32.6% of Renong shares to UEM at RM3.24 per share, 35% higher than cost price of RM2.40 per share (Asiaweek 3/11/2000). Later, PLUS, a Renong subsidiary, was used by Halim to fund Renong's debts. See Nor Azizah, 2004: 59-64

³³ Tajudin obtained personal loans amounting to RM1.8 billion from four banks to enable him to buy Bank Negara's share in MAS (Far Eastern Economic Review 8/7/1999)

³⁴ Malayan Banking Berhad (MBB) and Bumiputra Commerce Berhad (BCB) are examples of financial institutions owned by the government. The government through Permodalan Nasional Berhad (PNB), chaired by the Prime Minister, controls MBB. Commerce-Asset Holdings, subsidiary of Renong Berhad, controls BCB.

³⁵ Basic principles of corporate governance are transparency, fairness and trustworthy were not implemented.

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