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Conference paper:

The Way Forward – A Review of Current Policy Initiatives taken by the Malaysian Public Sector to address Corporate Governance Issues

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Abstract

In the aftermath of the East Asia Economic Crisis which began in July 1997, the Malaysian government has taken various measures to uplift the standards of corporate governance; recognizing the crucial role that enhanced standard of corporate governance can play in boosting investor confidence in the market. In March 1998, a high level committee was established by the Malaysian Ministry of Finance to examine a framework for corporate governance and to set best practices for the industry. At the same time, and in response to the global debate on corporate governance, the Kuala Lumpur Stock Exchange in conjunction with PricewaterhouseCoopers (PWC) initiated a survey on corporate governance practices of public listed companies and institutional groups. During the same period (March 1998), the Malaysian Institute of Corporate Governance comprising five professional bodies (the Federation of Public Listed Companies, the Malaysian Institute of Accountants, the Malaysian Association of the Institute of Chartered Secretaries and Administrators, the Malaysian Association of Certified Public Accountants and the Malaysian Institute of Directors) was established to draw up guidelines and code of ethics for the business community. The efforts of the Finance Committee have culminated in a report (termed the "Report of the Finance Committee") that sets out recommendations for the improvement of certain key aspects of regulation and the proposed Malaysian Code on Corporate Governance. The proposed code on corporate governance aims to set out best practices on structures and processes that public listed companies may use in their operation towards achieving the optimal governance framework, and was published in February 1999. Subsequently, the Finance Committee on Corporate Governance issued the Malaysian Code on Corporate Governance in March 2000. However, the most comprehensive and ambitious set of corporate governance reforms which even caught the attention of foreign scholars (e.g. Walker & Fox, 2002) is the Capital Market Master plan which was issued by the Malaysian Securities Commission in February 2001.

This paper intends to critically examine the various measures taken by the Malaysian government to date to improve corporate governance practices. Attempts will be made to discuss the various reports issued since the onslaught of the East Asia economic crisis and determine its adequacy as well as its implications to the future state of corporate governance standards in the country.

Introduction

The East Asia Economic Crisis 199798 was the catalyst in which the Malaysian government took various measures to uplift the standards of corporate governance; recognizing the crucial role that enhanced standard of corporate governance can play in boosting investor confidence in the market.

This paper intends to critically examine the various measures taken by the Malaysian government to date to improve corporate governance practices. Attempts will be made to discuss the various reports issued since the onslaught of the East Asia economic crisis and determine its adequacy as well as its implications to the future state of corporate governance standards in the country.

The reports covered in this paper are the high level committee report of the Malaysian Ministry of Finance to examine a framework for corporate governance and to set best practices for the industry, the joint report of the Kuala Lumpur Stock Exchange and PricewaterhouseCoopers (PWC) on corporate governance practices of public listed companies and institutional groups, the Malaysian Code on Corporate Governance issued by the Finance Committee on Corporate Governance in March 2000, the National Economic Recovery Plan, released by the National Economic Action Council in late 1998, and the Capital Market Master plan which was issued by the Malaysian Securities Commission in February 2001.

The National Economic Recovery Plan

In the aftermath of the Economic Crisis of 1997/98, the Malaysian government sprang into action by forming the National Economic Action Council (NEAC) to chart out a national economic recovery plan. The interesting part of the report is that it recognized that weaknesses in the financial sector, inadequate disclosure of information, and data deficiencies increased uncertainties and adversely affected confidence. The report added that there was also a lack of transparency in policy implementation, and acknowledged that the central issue was the lack of confidence rather than macroeconomic fundamentals. The main problems, as mentioned, were weak supervision of the financial sector, inadequate corporate governance and manipulation by unscrupulous players. The NEAC called for more emphasis placed on good corporate governance, i.e. a need to introduce a framework for strengthening corporate governance. Among its recommendations include enhanced disclosure of corporate information, improve transparency and regulatory environment, protection of minority investors, and greater enforcement of market regulations under the jurisdiction of the KLSE and the Securities Commission. It further called on the KLSE to ensure that the new client asset protection framework is implemented soonest possible. Also, the KLSE should revise voluntary suspension rules and strictly enforce their application. It noted that the legal framework must make it easier for the public to report corruption and that Malaysia should publicly commit to make its regulatory environment as good as other countries. Finally, controlling shareholders and owners who have committed malpractices in the management of PLCs through fraud or manipulation of share trading and asset stripping should be prosecuted expeditiously. All the above recommendations of the NEAC recognize that the state of corporate governance in Malaysia is inadequate and this augurs well for the country. There is political will to improve governance practices.

A Review of the Malaysian Code on Corporate Governance

The March 2000 Code draws heavily on the principles promulgated in the UK's Cadbury Code of Best Practices (1992) and the UK's Hampel Committee Report on Corporate Governance (1995). The Malaysian Code is therefore expected to be of international standards. Certain principles relating to corporate governance practices expounded in the Malaysian code will be examined to assess its adequacy and effectiveness in implementation.

a. Board balance, structures and processes

One of the principles in the Malaysian Code states that the board should include a balance of executive directors and non-executive directors such that no individual or small group of individuals can dominate the board's decision making. Part 2 on the Code, which recommends best practices in corporate governance, states that non-executive directors should be persons of caliber, credibility and have the necessary skill and experience to bring an independent judgement to bear on the issues of strategy, performance and resources including key appointments and standards of conduct. The Code went on to elaborate; to be effective, independent non-executive directors need to make up at least one third of the membership of the board. There is little empirical evidence to back up what the Malaysian Code has promulgated. However, given the mixed and often conflicting results of empirical studies, these recommendations represents the best compromise in these circumstances. As a consequence of the economic crisis of 1997/98, the Malaysian authorities have to be seen to improve standards of corporate governance in the country. The Code draws its recommendations from the industry wide survey of corporate governance of institutional groups in 1998 conducted by PWC and the KLSE.

In an attempt to dilute the dominance of concentrated ownership, which is seen as having a negative influence, the Malaysian Code states: in circumstances where a company has a significant shareholder, in addition to the requirement that one third of the board should comprise independent directors, the board should include a number of directors which fairly reflects the investment in the company by shareholders other than the significant shareholder. The Code recommends that this should be disclosed on an annual basis. This is an attempt to bring in minority shareholders into the boardroom – a laudable move to boost investor confidence.

On recommendations to strengthen board structures and procedures, the Code states: the board should meet regularly, with due notice of issues to be discussed and should record its conclusions in discharging its duties and responsibilities. The Code further adds that the board should disclose the number of board meetings held in a year and the details of attendance of each individual director in respect of meetings held. Also, the Code provides for access to information, stating that there should be an agreed procedure for directors, whether as a full board or in their individual capacity, in furtherance of their duties to take independent professional advice at the company expense, if necessary. This is a laudable move and reflects the seriousness of the relevant authorities to strengthen governance at board level where all important decisions on company affairs are made.

b. Chairman and CEO

On this issue, the Code states: there should be a clearly accepted division of responsibilities at the head of the company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. It further adds: where the roles are combined there should be a strong independent element on the board, and that a decision to combine the roles of Chairman and Chief Executive should be publicly explained. These recommendations are very similar to those found in the Cadbury Report, 1992. In an attempt to make the process more open, the Code states: whether or not the roles of Chairman and CEO are combined, the board should identify a senior independent non-executive director of a board in the annual report to whom concerns may be conveyed. These are good measures to ensure that excesses can be given due attention by the company.

c. Nomination Committee

The Code recommends: the board of every company should appoint a committee of directors composed exclusively of non-executive directors, a majority of whom are independent, with the responsibility for proposing new nominees for the board and for assessing directors on an on-going basis. It further adds: the board, through the nominating committee, should annually review its required mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board, and that this should be disclosed in the annual report. This is a good move, as such a committee was cited by academics (such as Klein, 1998; Laing & Weir, 1999) as a better alternative due to its perceived independence and competency to concentrate on the thorny issue of board appointment.

d. Remuneration Committees

Recognising the need for better accountability on directors pay, the Code states: boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors, to recommend to the board the remuneration of the executive directors in all its forms, drawing from outside advice as necessary. It further adds: Executive directors should play no part in decisions on their own remuneration, and that membership of the remuneration committee should appear in the directors' report. This recommendation is intended to avoid conflict of interest, in particular self-serving vested interests. This is again a good move, well in line with the trend that is now becoming common practice for large corporations in the west.

e. Audit Committees

This committee has now become a standard feature in most developed countries, and the KLSE listing rules already has made it compulsory for Malaysian firms to have such a committee. To further clarify its role, the Code states: the board should establish an audit committee of at least three directors, a majority of whom are independent, with written terms of reference which deal clearly with its authority and duties. It further adds: the chairman of the audit committee should be an independent

non-executive director, and that the audit committee must have explicit authority to investigate any matter within its terms of reference, the resources it needs to do so and full access to information. Also, the committee should be able to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary. The Code also requires that the board should disclose in an informative way, details of the activities of audit committees, the number of audit meetings held in a year and details of attendance of each individual director in respect of meetings. While the Code has clarified and expanded the role of the audit committees and giving it more power, there is no mention of the members' competency, qualifications and experience. The literature states that such skill and experience form the substance of the committee, rendering them more effective. Fortunately, the KLSE listing rules requires that members of the audit committee must have at least three years working experience and have professional accounting qualifications. This has addressed the weakness found in the Code.

f. Directors' Training

Recognising that directors in Malaysia have a very important role to play in overseeing the corporate governance reforms proposed, the Code states: As an integral element of the process of appointing new directors, each company should provide an orientation and education program for new recruits to the board. Such an education program gives an invaluable opportunity for the relevant authorities to inform the directors of the new rules to strengthen corporate governance structure in the country. This is a good start for a developing country like Malaysia, where directors may have been appointed not due to their competency, but by virtue of their political connections. These business politicians, which are quite substantial in numbers, have very little technical or managerial skills, and are more likely to expropriate assets from the minority shareholders in the process of enriching themselves. Hopefully, such training can instill greater professionalism in these directors and drilled them on the need to uphold the supremacy of the law and other regulations.

The Malaysian Code states that companies will be required by the listing requirements of the KLSE to include in their annual report a narrative statement of how they apply the relevant principles (Part 1 of the Code) to their particular circumstances. This is to secure sufficient disclosure so that investors and others can assess companies' performance and governance practices, and respond in an informed way. Part 2 of the code recommends best practice in corporate governance and states: while compliance with best practices is voluntary, companies will be required as a provision of the listing requirements of the KLSE to state in their annual reports, the extent to which they have complied with the best practices set out in Part 2 and explain any circumstances justifying departure from such best practices.

The Code looks good on paper, but its compliance may be difficult to monitor. It remains to be seen how enforcement can be effectively made. There is no requirement for these provisions to be audited by external experts, other than the KLSE. It would have been good if the external auditors can be involved to report on any departures from best practice. Therefore, it is currently premature to gauge its effectiveness in uplifting the standards of corporate governance in Malaysia.

Capital Market MasterPlan (CMM, 2001)

This is a very comprehensive 10-year masterplan for the development of the Malaysian capital market. It is divided into three phases of implementation up to year 2010 with a review every 5 years. The Securities Commission (SC) is tasked to implement the proposals contained in the report. The report recognizes that the aftermath of the economic crisis of 1997/98 had an adverse impact on investor confidence in the Malaysian capital market. This has resulted in the impetus for more comprehensive and co-ordinated reforms to improve corporate governance. The SC recognizes a world-class capital market must have a transparent, accountable and performance-oriented corporate sector that is premised on sound and consistent governance of corporate activity. Good corporate governance is vital for ensuring that the Malaysian capital market provides a conducive environment for investors.

Structural change and financial innovation have rendered the continued maintenance of these traditional structures sub-optimal, hence a revamp of the existing regulatory system was needed. In this connection, there is a need for the regulatory framework to be flexible and effective in adapting to the fast changing market environment.

Weaknesses in the current regulatory framework

The SC in the Masterplan recognizes a number of weaknesses in current regulatory framework. It was developed on an incremental basis. Legislative activity has by and large taken place to address perceived or potential failures in the system or to address the need to protect investors. Consequently, the regulatory approach is one that is based on the specific purview of the regulatory agency, such as Bank Negara Malaysia over the banking system and its intermediaries and insurance industry, and the SC over the regulation of the securities and future markets and non-bank intermediaries in the capital market. In addition, the Registrar of Companies also exercises regulatory authority over financial market participants in its administration of duties, rights and obligations pertaining to public companies, their directors and officers as well as investors. This has caused overlaps in the jurisdictions of the various agencies and consistencies within the regulatory framework. These overlaps and inconsistencies result in:

- Inefficiencies – duplicative regulation often leads to considerable difficulties, particularly in the area of enforcement.
- Differing standards of investor protection for similar risks. This leads to conflicts and differing standards of disclosure for similar investment products.
- Unequal treatment of participants.

Another weakness in the current framework is the inavailability of timely, relevant and accurate data. So is corporate accountability by Malaysian companies. Corporate governance concerns are still cited as a pertinent factor in many investors' minds in making their investment decisions. Also, there is little active participation by major institutional investors.

Strategies to improve the Malaysian Capital Market

a. Establishment of a robust regulatory framework.

There will be a gradual move towards a disclosure based system of regulation for the primary offering of securities, introduced the due diligence concept, and created both criminal and civil liability provisions for contravention of the law. The SC's investigative powers were enhanced to strengthen the effectiveness of its enforcement programmes. Several key strategic initiatives have been identified:

1. There will be gradual implementation of market-based regulation across the capital market. This move represents a shift in regulatory philosophy on the SC's part towards the use of competitive market disciplines rather than direct intervention.
2. Efforts will be undertaken to strengthen enforcement activity and enhance systemic risk management within the capital market.
3. Greater use of incentive structures that promote a high level of compliance.
4. Enhanced disclosure and transparency, as well as greater regulatory accountability and dialogue.
5. The framework will allow for more flexibility, innovation and competition while maintaining mechanisms for ensuring high standards of investor protection and market integrity.
6. Stronger enforcement action that is timely and impartial, with sufficient deterrent penalties and measures to ensure that there is sufficient regulatory capacity in this regard.
7. The SC recognized that enforcement should also make use of remedies where appropriate, that allows swifter and more immediate actions to effectively prevent further abuse or damage to the market.
8. The Malaysian exchange should pursue appropriate strategic alliances internationally. Such alliances have become an important commercial strategy for many exchanges and other market institutions, in response to the more competitive environment and increased uncertainty over where the businesses of exchanges and clearing institutions can generate most value in the marketplace. In their efforts to enhance value recognition, smaller exchanges are increasingly leveraging on strategic linkages among one another, as well as with large hubs, to garner critical mass.

Disclosure Based Regulation (DBR)

The move from merit-based regulation[1] to disclosure-based regulation[2] (DBR) was initiated in 1996 to reduce the involvement of the SC in assessing the merit of investment opportunities, and enhance the role of the private sector in capital allocation and decision-making. The SC has initiated a gradual shift in its regulatory

[1] The Malaysian merit-based assessment covers the financial viability and growth prospects of the company; the quality, integrity and capability of the management of the company; the utilization of proceeds raised from the issuance of securities; and the interests of the public.

[2] DBR entails higher standards of disclosure, due diligence and corporate governance as well as accountability by promoters, directors, and advisors of public companies to investors. DBR reduces the costs of approval and provide efficiency gains as the market grows in depth and breadth.

framework from merit-based regulation to DBR over three phases and moved to a full disclosure based environment in 2001.

Measures taken so far toward the implementation of full DBR include the enhancement of disclosure requirements and enforcement powers, the promotion of good corporate governance and a refinement of listing requirements. Public listed companies (PLCs) will be required to provide appropriate shareholder value disclosures for securities issuance, restructuring, take-overs and merger exercises. The SC's emphasis on shareholder value maximization include education company directors and management on the importance of maximizing shareholder value as well as their duties in this regard.

The SC will also encourage the improvement of channels of communications between companies and their shareholders. While the disclosure of information is often provided by legislation, filing procedures and access to information can often be cumbersome and costly. One approach to mitigating this problem is the setting up of investor relations units by companies to deal specifically with requests and querries by shareholders. This will facilitate the transfer of information to investors about corporate issues that they consider relevant to the exercise of their rights as shareholders.

It is also recognized that electronic reporting can benefit businesses by reducing the costs of reporting, enabling more prompt reporting and facilitating the dissemination of information to a wide audience. To facilitate the process, the SC will work with KLSE and Malaysian Accounting Standards Board (MASB) to provide guidelines on the disclosure of information by PLCs through electronic media. Regulators in countries such as France and Canada have introduced similar guidelines on electronic communications and disclosures in recent years. Also, mechanisms to facilitate electronic filings by listed and other regulated companies with the SC will be implemented. A number of countries such as the US allow electronic access to company filings. This has vastly expanded the accessibility and availability of corporate information about listed companies.

Other measures taken to improve corporate governance include:

1. On 2 July 1998, amendments were made to the KLSE Listing Requirements to strengthen provisions on related party transactions i.e. transactions involving the interests of directors or substantial shareholders of public listed companies and persons connected to such directors or substantial shareholders. These amendments seek to ensure that minority interest is sufficiently safeguarded and to enhance the overall framework.
2. A new Malaysian Code on Takeovers and Mergers 1998 came into force on 1 January 1999 pursuant to the Securities Commission Act 1993. This new code replaced the Malaysian Code on Takeovers and Mergers 1987. The new code seeks to ensure that minority shareholders are given a fair opportunity to consider the merits and demerits of a take-over offer and to enable them to decide whether to retain or dispose of their shares. Its objectives are to address deficiencies found in the Code of 1987, to further protect minority interests and to ensure higher standards of disclosure. The new regulatory framework includes

provisions which impose criminal liability on the relevant parties to a take-over offer for providing false or misleading information.

3. On 30 June 1999, the quarterly reporting requirements was made mandatory for PLCs. The quarterly reporting regime is expected to make available to investors, material information on the financial position of PLC in a timely, adequate and accurate manner to aid investors in making informed investment decisions. It is also aimed at enhancing corporate governance as corporate activities on the PLCs are made more transparent to investors. Most advanced countries, such as the US has already practiced quarterly reporting for many years.
4. The KLSE has amended the Listing Requirements to restrict the number of directorships that may be held by directors of PLCs, to not more than ten in PLCs and not more than fifteen directorships in non-PLCs. This amendment seeks to make directors of PLCs to focus more time and energy on a smaller number of companies, thus increasing the effectiveness of the board of directors. This should also encourage greater accountability and hands-on involvement by these directors in ensuring that their companies are well-run.
5. Amendments were also made to the Securities Industry Act (SIA) on areas such as insider trading to further strengthen provisions relating to investor protection, safeguarding market integrity and promoting proper conduct.
6. Other law reform efforts were related to the provisions for the full immobilization of securities and for curbing the abuse of the nominee system of share ownership.
7. Amendments are also made to encourage equity participation by non-executive directors, and the codification of key duties of directors.
8. Other steps taken to support the development of greater shareholder activism include the formation of a minority shareholder watchdog group and the introduction of mandatory director accreditation training programmes. At the same time, the continued push towards educating investors as to their rights and responsibilities remains a priority of the SC's training arm, the Securities Industry Development Centre.
9. SC will make attempts to further enhance the awareness of and accountability for the fiduciary duties of company directors, management and officers; and ensuring the availability of adequate mechanisms for investor recourse.
10. The SC will beef-up the skills of enforcement officers by continuously equipping them with up-to-date knowledge on financial transgressions, policing and increasing domestic and cross-border surveillance; and greater co-operation with regulatory agencies in other jurisdictions.

b. Emphasis on Investor Protection

The SC recognizes that investor protection remains a priority. There will be measures to enhance investor empowerment through a strengthening of rules in relation to shareholder rights and making available alternative avenues for the redress of grievances. These efforts will be supported by continued efforts at promoting investor education to ensure investors are fully aware of their rights, the risks they face and available recourse in relation to their investment activities. In addition, further efforts will also be directed at further improving the standards of business conduct of market participants and regulated entities. The SC will also strengthen mechanisms to increase information flows to and from investors to ensure that investor protection is not compromised.

A drastic step to improve investor protection is the introduction of an investor compensation programme for the Malaysian investment management industry. No time frame was given for its implementation. Investor Protection Programmes add value to the industry as it leads to increased confidence in investment management products and services.

The SC will take steps to introduce a statutory derivative action[3] and cumulative voting[4]. The SC views the introduction of these initiatives as being critical as these mechanisms enhance investor empowerment by further strengthening the policing ability of minority shareholders. These minority shareholders need to be protected from the dominance of unscrupulous large shareholders and owner-managed companies that are common place in Malaysia. This statutory derivative action will not impose a new form of liability to directors, but rather remove uncertainty and therefore provide a more effective mode by which directors' duties can be enforced. Codifying the derivative action would potentially create a valuable tool to enhance corporate governance and investor confidence. Other countries such as Australia, Singapore and Canada have also introduced such laws. On the other hand, cumulative voting is an important mechanism for providing large minority shareholders, especially institutional investors with an effective voice at the board of directors by putting their representative on the board. This allows these investors greater access to information about the company's activities than they would normally be able to obtain from the company's public disclosures. Cumulative voting is currently practiced in certain common law jurisdictions such as Canada and some states in USA.

Minority shareholder rights in respect of related party transactions will be further strengthened. Currently, section 132E of the Company Acts prohibits a company from entering into any arrangement or transaction with its directors to acquire or dispose of any non-cash asset, unless approval of the shareholders in a general meeting has been obtained. However, these laws allow for a transaction to be ratified by shareholders subsequently to its execution, and do not prevent persons with an interest in the transaction from voting, so long as the interests are disclosed. The SC and KLSE have made revisions to existing rules in 1998 to provide greater protection to the rights of minority shareholders. The KLSE Listing Requirements now require a company to appoint an independent corporate advisor to advise the minority shareholders of the company, whether the transaction is fair and reasonable. Also, the Listing Requirements now prevent directors, substantial shareholders and connected persons from voting on any resolution on a related or interested party transaction. The SC has established a Technical Reference Panel to handle complaints as well as investor alerts to increase information flows to and from investors.

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[3] A derivative action allows shareholders or directors of the company to bring an action on behalf of the company for a wrong done to the company where the company is unwilling or unable to do so. Currently, a shareholder of a company can only undertake a derivative action under common law. However, the practical difficulties and cost considerations of enforcing this rule have made it extremely difficult for minority shareholders to enforce this right.

[4] Under cumulative voting, a shareholder is allowed to cast all his votes for one candidate standing for election on the board of directors, as opposed to casting one vote for each candidate. The shareholder is therefore allowed to cumulate his entitlement to one vote per candidate and cast it all in favor of one director.

The SC will strongly support the efforts of Badan Pengawas Pemegang Saham Minoriti Bhd. (BPPSM) in promoting shareholder activism in Malaysia. The SC recognises that investors in the Malaysian capital markets generally lack sufficient information by independent sources on issues relating to the corporate governance standards adopted by PLCs. It is essential for investors to have access to independent and critical analyses of such matters in order for them to be in a position to assess the companies' performance and respond in an informed manner. Therefore, the presence of an independent shareholder watchdog is welcomed. Such groups can establish efficient channels of disseminating information, such as through websites and other media, in order to provide minority shareholders with the necessary information required to undertake a comprehensive assessment of the standards of corporate governance practiced by PLCs. The setting up of BPPSM, an independent minority shareholder watchdog group spearheaded by the Employees Provident Fund, is a significant step towards encouraging greater shareholder activism in Malaysia. The watchdog group's primary role is to monitor and combat abuses by insiders against the interests of minority shareholders. As an organisation representing the largest institutional investors in Malaysia, BPPSM is currently the best candidate to undertake the dissemination of such information to the public. The work that may be carried out by this watchdog group includes the provision of analyses of governance issues such as the composition of the board of directors of a company and its independence from the controlling shareholders, and advise to shareholders on the pros and cons of recent resolutions put forward by the boards of these companies.

c. Enhancing the Role of Institutional Investors

Institutional investors[5] typically hold a substantial number of shares in Malaysian companies, and are therefore expected to significantly influence the level and direction of market activity[6]. This group of investors has natural access to larger pools of funds and resources than the average retail investors. As fiduciaries of their clients' interest, institutional investment companies wield significant power in influencing the governance of the companies they invest in, whether by means of direct voting involvement or through their investment decisions. Institutional investors can therefore play a significant role in ensuring that the firms they invest in place due priority on value creation.

The SC intends to deregulate the restrictions that are currently imposed on institutional investors, and promote a high degree of awareness among these institutional investors of their governance role with regard to the companies they invest in. This emphasis will be promoted through the training and continuous education of investment professionals and directors involved in the management of these institutional funds. Reinforcing these efforts will be the cultivation of a large pool of highly skilled professionals to help foster greater innovation and built up

[5] This special group include asset management companies, unit trust management companies, pension funds and state-controlled funds, insurance companies, banks and securities houses that invest for their own accounts as well as on behalf of their customers.
[6] At the end of 1999, institutions held up to 41% of total equity on the KLSE although they constituted only 1.7% of the total number of investors. Of this amount, the majority of institutional equity ownership was held by Malaysian institutions (SC, 2001).

critical mass within the industry. The SC will collaborate with specific representative associations of institutional investors to publish a set of principles, best practices and standards for use by the respective members in determining their approach to promoting corporate governance. There should be an evaluation of the appropriate shareholder value maximisation disclosures that institutional investors should be required to provide to their clientele with regard to their investment decisions.

An ancillary benefit of more active domestic institutional participation in the capital market is that it fosters more institutionally based shareholder activism and, as a result, encourages stronger corporate governance. In addition, the SC will take measures to facilitate the development of a viable private pension fund industry through the establishment of a more facilitative environment with appropriate incentives, which includes a review of the current tax treatment and allowing employer contributions to EPF be channeled into privately managed pension schemes of the employee's choice. This is clearly a good move, and such ideas had already been implemented for quite some time in Singapore.

d. Fostering Market Competition and Liberalisation

Various forms of liberalisation are now being considered, such as the employment of skilled foreign personnel, the freeing up of limits on foreign ownership of domestic institutions, and the physical establishment of foreign-controlled institutions' officers locally. This is particularly pertinent in view of the rapid steps taken by other countries in the region such as Singapore, to loosen foreign ownership restrictions on their capital market intermediaries. This can accelerate the development of our financial markets. Also, greater foreign participation in the venture capital industry should be allowed. Venture capital companies are typically subject to foreign ownership restrictions, but the SC has proposed that these restrictions be liberalised for foreign equity participation of up to 100%. The SC also intends to allow foreign majority ownership in futures broking firms by 2003. This can be facilitated by liberalising current limits on foreign equity ownership and allowing foreign parties to acquire a majority stake, subject to buying a stake in an existing futures broking company in Malaysia. Allowing greater foreign entry into the stockbroking industry under a programme for liberalisation is a good move as it could introduce greater competition in the marketplace. Also, foreign ownership requirements will be liberalised to allow foreign majority ownership of unit trust management companies from 2003. This proposal can again introduce greater competition through enhanced foreign participation.

The SC intends to further deregulate the market for the provision of corporate advisory services. This will enhance the competitiveness of the equity fund-raising process and expand the categories of advisors that are authorised to provide the full range of corporate advisory services. In a move to extent these reforms further, breath of listings in the Malaysian equity market will be gradually widened to include listings of foreign companies. This is part of the liberalisation process, and is expected to increase the diversity and quality of issuers in the Malaysian capital market. There will also measures to eliminate market segmentation in respect of underwriting, corporate finance, asset management, and brokerage services. Innovation in products and technology, as well as increased consumer sophistication

are combining to challenge the traditional segmentation of financial services. Intermediaries today are increasingly expected to deal in and advise on securities futures and other investment products. Effective financial services regulation should therefore, allow for rigorous competition among all market participants. The SC will make changes to facilitate the broadening of services catering to the primary and secondary markets in securities through the removal of market segmentation with respect to the provision of underwriting, corporate finance, asset management and brokerage services.

e. **Promoting Auditors Independence**

The issue of auditor independence has received significant attention in recent times, particularly in the US. Accounting irregularities in Enron and WorldCom lead to a declining stock market, and a consequent adverse impact on the US economy in 2002. This has been prompted mainly by evidence of a growing dependence by public accounting firms on fee income from consulting services as well as the increasing number of business relationships between auditors and clients. This had tarnished the ability of auditors to be independent when discharging their statutory responsibilities.

The conduct of auditors for Malaysian PLCs is currently supervised by a number of regulatory and self-regulatory bodies. The Malaysian Institute of Accountants (MIA), a statutory body, has powers to conduct investigations and undertake disciplinary action against auditors (such as de-registration), while the Registrar of Companies (ROC) may take action against auditors for breaches of the Companies Acts. The SC is able to take actions against professional advisors including auditors, under the the Securities Commission Acts (SCA) and its 'Policies and Guidelines on Issue/Offer of Securities' if false or misleading information is found to have been provided in a corporate submission.

The SC will work with relevant industry bodies in enhancing the quality and independence of auditors of PLCs. A working group will be established comprising representatives from the SC and other relevant bodies to examine the future role and responsibilities of the auditing profession; and to conduct a review of the approach to be taken with regard to the regulation of the profession.

Investors should be provided with sufficient information to enable them to evaluate the independence of the company's auditors. Proposed changes to the current framework will encompasses the introduction of additional disclosures by companies on the non-audit services provided by their auditors. Also, auditors may be required to report on certain issues such as fraud. The framework may also identify non-audit services that, if provided to an audit client, would impair an auditor's independence. Also, under consideration are the rotation of auditors within a specified time period, and the establishment of a peer review programme among accounting firms. Incidentally, Singapore is also trying to address the same sensitive issue as well. There has been strong opposition from the auditing profession in Singapore regarding the issue of the rotation of auditors. The argument against the proposal seems to be weak, and indicate that the profession is trying to protect its own self-interest. It remains to be seen if it could be implemented in Malaysia.

Concluding Remark

The country has learnt well from the last economic crisis. It had introduced wide-ranging corporate governance reforms, invited foreign experts (US financial firms) to formulate its Capital Market MasterPlan (CMM), and welcomed liberalization as a strategy to enhance the strength of its capital market. This is also in line with the spirit of AFTA (Asean Free Trade Area) which advocated liberalization of the Malaysian services sector. The government, it seems had seized the rare opportunity to improve corporate governance practices in the country to be in line with the world's best. It also had taken many cues from its neighbour, Singapore which had earlier on embraced western governance standards and was virtually left unscathed by the East Asia economic crisis of 1997-98. Some of the ideas proposed in the CMM were already in place in Singapore, but there are also many provisions which are now ahead of Singapore. If these ideas are fully implemented and enforced, Malaysia stood to gain in the long term.

Some of the liberalisation provisions, e.g. inviting foreign talents and opening up the brokerage securities firms, maybe politically sensitive to implement. However, Malaysia must realise that money alone doesn't build Silicon Valley. This is a task for open societies that draw on the world's best brains. I see only two things Malaysia can do, and they are inseparable: opening up the country and its institutions. The problem is that you can't rebel in Malaysia, so the most talented young people are leaving the country or are simply resigned to hope for the best. This is clearly unsatisfactory. A sense of meritocracy and fair-play has to be instituted if the country is to progress to the level of advanced countries. Our neighbour, Singapore has always been ahead on these issues. How long must we wait? In an era of globalisation, there is great mobility of talented people and money. Who would be interested to put their money and talents in a country with questionable enforcement of the laws and corruption is endemic. Both private and public governance systems must be greatly improved to achieve Malaysia's goals to be a truly respectable international capital market. The task on hand is rather daunting, but the country has made a good start at the moment. Malaysia must realise that beautiful rules alone will not achieve the governance standards that ensures prosperity for all. Enforcement of these rules fairly and prudently is equally crucial.

The Capital Market Master-Plan seems to be well-thought out, and the SC seem very serious in carrying out its proposals as outlined in the master-plan with definitive datelines set for implementation. Currently, there is strong political will to carry it out due to the sluggish stock market performance and the memories of the recent economic crisis is still fresh in their minds. However, it remains to be seen if the SC will have the steam to implement fully all these proposals which actually looked good on paper.

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