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All eyes on the Code

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IT would take more than just a Code on Corporate Governance to ensure that past corporate misdeeds are not repeated. Four years after the Code was introduced, Malaysia is still having to contend with, at times, deliberate acts of corporate misconduct.

Market participants at a recent Malaysian Business roundtable discussion on Corporate Governance - The Next Step, generally feel that while it is still early for strict application of the Code, more needs to be done in the enforcement of the laws, which is perceived as lacking.

But, all the good intentions are not in vain as the widespread public notion of poor corporate conduct in Malaysia following the massive fallout from the 1997 regional financial crisis appears to be dissipating.

A sign of a change in sentiment can be seen from the latest Kuala Lumpur Stock Exchange-PricewaterhouseCoopers (KLSE-PwC) survey on Corporate Governance (CG). Some 93% of investors and 84% of public-listed companies polled felt that Malaysia's standard of corporate governance had improved since the issuance of the Code in 2001.

The 2002 survey also found that the CG gap between the country and Hong Kong, Singapore and Australia had narrowed in comparison to 1998, while another report revealed that Malaysia scored nine out of 10 in terms of regulatory framework.

On top of this, investment bank CLSA Emerging Markets, in its fourth report dated April 2003 on Corporate Governance in Asia, in collaboration with the Asian Corporate Governance Association, had also noted that the country had taken steps in the right direction.

'Singapore, Hong Kong and India are seen as offering investors the best macro CG environments of the markets we cover, whereas Indonesia, the Philippines and China are the riskiest. For their part, Korea and Malaysia have seen the highest improvement in our macro CG scores since we began these in 2001,' it said.

Nonetheless, this encouraging development masks a nagging concern of whether the numbers really tell the whole story.

'There seems to be a disparity between the current state of affairs and the encouraging survey findings, in terms of the number of PN4 companies still unresolved and the occasional "Maruichis" and "CSMs",' says an investor.

Between enforcement and education

So, what does it take for Malaysia to regain the confidence of market players in terms of its CG practices? Is it just a matter of enforcement of the Code, much in tune with the saying that justice must be seen to be done?

From the regulators' standpoint, enforcement is not an issue as efforts have been stepped up to bring those who breach the law to book, as reflected by the number of companies and directors reprimanded or taken to court thus far. Apart from this, they say it's a misconception to think that enforcement is required, as the good practices set out in the Code are voluntary.

Notes Securities Commission (SC) Director of Market Policy and Development Division, Dr Nik Ramlah Nik Mahmood, 'When we talk about enforcement, it is the enforcement of all laws that deal with corporate deeds that can be from the securities law, Companies Act, the common breach of trust, theft and whatever it may be.'

She says people have to look at enforcement from a broad picture and not just in respect of the Code, as what is mandatory is disclosure on the extent of compliance, as per the listing rules.

'We talk about inculcation of good behaviour among our children, so we talk about initiatives at inculcating good corporate governance,' she adds.

Datuk Seri Megat Najmuddin Khas, President of the Federation of Public Listed Companies, has the same view. He says good corporate governance goes beyond enforcement of the rules and regulations as it also involves the inculcation of ethics and honesty as a long-term approach to curb corporate misdeeds.

'Enforcement anywhere in the world is easier said than done. And that is why the code of corporate governance is voluntary. It is only disclosure compliance that is mandatory. So, I think the question of asking for strict enforcement is not entirely to the point,' he says.

If the number of court cases, reprimands and fines are anything to go by, there is undoubtedly an increase in enforcement by the SC, which last year prosecuted 14 individuals in the criminal courts for various offences. The KLSE, meanwhile, initiated 207 cases against listed companies for breaches of listing requirements, in its financial year ended June 30, 2002.

One of the high-profile court cases involved Datuk Soh Chee Wen who was charged for his involvement in certain contango and off-market transactions that were carried out in various margin accounts in now defunct Omega Securities, which resulted in withdrawal of sales proceeds of RM520m from the stockbroking firm.

Other big names taken to court were Datuk Ishak Ismail, a director of Idris Hydraulic (M) Bhd, who was charged with abetting the company to redirect RM50 million of public proceeds for purposes in breach of the SC's condition, and Datuk Tiah Thee Kian, a former chairman of TA Securities who pleaded guilty to furnishing false statements to the KLSE and was imposed the maximum fine of RM3 million, the highest ever recorded (see tables on offences).

But, as newsworthy as these cases may be, not everyone is impressed, as shown by the 2002 KLSE-PwC survey that suggested the need for greater enforcement. 'Although Malaysia is perceived to have an improved CG position relative to its Asian peers, the survey indicates that there is scope for improvement, particularly in the enforcement of existing rules and regulations,' it said.

In fact, the corporate scandals that rocked the US and Europe in 2001 reinforce the fact that no jurisdiction can be complacent in this area.

'The perception is that there is insufficient enforcement. We need to see some level of enforcement,' says IG Chandran, partner with accounting firm KPMG.

Indeed, this is sometimes used as an excuse by investors not wanting to put their money in the KLSE. But, this may not be a factor, as during a bull run everyone jumps on the bandwagon.

Even Prime Minister Datuk Seri Dr Mahathir Mohamad noted this in late-2000 when he said, 'Nobody makes any comment when the companies are doing well, but now (due to the economic slowdown) everybody seems to know which is good and bad governance.'

As to the regulatory framework, while it's recognised that they are of high standard, there are shortcomings.

'What you cannot do by rules or teach is that if people want to be dishonest, they will be dishonest, as you have seen in the bigger collapses because the perfect tradition of dishonesty will start at the top. When that happens, no amount of regulatory framework can fix that,'

Chandran says.

This explains why Megat Najmuddin firmly believes in education playing an important role in raising the level of awareness on good governance in the long term.

‘Everything boils down to the directors. They are the ultimate decision-makers in the corporate process. So, that is why our emphasis now is on the directors. We want them to be educated. We want them to be manageable. But first of all, we want them to be aware that there is this need for good corporate governance and of the fact that we need them to be people with integrity, because that is the basis of good corporate governance,’ he stresses.

Hybrid or prescriptive?

A catchphrase in today's financial markets, corporate governance is defined as the process and structure by which the business and affairs of a company are directed and managed to enhance business prosperity and corporate accountability, with the ultimate aim of realising long-term shareholder value, while taking into account the interests of other stakeholders.

The definition varies depending on the jurisdictions and the various corporate governance committees set up overseas, but all have a common objective of ‘enhancing shareholder value without conflict of interest’. Minority Shareholder Watchdog Group chief executive officer Yusof Abu Othman prefers this concise version.

‘If every word were understood in an ethical fashion, then all the definitions that we have would be covered,’ he says.

In reality, good corporate governance is a combination of many factors, namely disclosure and transparency, sound regulation and enforcement, shareholder activism and professional and ethical management.

Ideally, each of these factors should progress alongside each other, although in enforcement the enabling framework has to be in place first and this ‘includes the regulatory framework, shareholder activism, the professionalism of the auditors and those who test the accounts’, says Nik Ramlah.

From this perspective, application of the Code is just one aspect of overall efforts to enhance the standards of corporate governance among corporations. Malaysia has taken the hybrid approach, which is voluntary compliance with a set of best practices but mandatory in disclosure on the extent of compliance. This is opposed to the prescriptive and non-prescriptive approaches. By prescriptive, it means the standard of corporate governance is set by specifying desirable practices coupled with a requirement to disclose compliance with them.

A non-prescriptive approach simply requires actual corporate governance practices in a company to be disclosed. In other words, companies decide what their actual corporate governance practices will be, on the premise that the directors know best what's good for the company.

China is one of the countries that apply the prescriptive approach, while Australia adopts the non-prescriptive method. Usually, the more developed the country, the less prescriptive the Code.

Nevertheless, five years after the establishment of the Finance Committee on Corporate Governance in 1998, some are beginning to question the wisdom of Malaysia's hybrid approach. Yusof suggests that the country should perhaps assume a more prescriptive approach rather than a voluntary one.

In fact, taking it a step further, he proposes a time frame to gauge the effectiveness of the Code rather than leave it open-ended. ‘I think it is timely to have a look at it. Not that we want to ape the American concept of moving from laissez faire to prescriptive, but there must have been a

reason.

'The point that I am trying to raise is, has someone, during the period when they were sitting down formulating this, say how much time they should have? Good businesses demand a time frame,' he says.

But, those hoping for the authorities to depart from the norm may be a bit disappointed.

Both the SC and the KLSE are firm that application of the Code will remain a voluntary initiative, much in line with the approach taken by the greater majority, in which a survey conducted by the East Asia and Oceania Stock Exchange Federation found that 75% of their member respondents adopted the hybrid approach.

'The Finance Committee in its ultimate wisdom felt that the Code has to be industry-driven so that it has greater acceptability, and what we have done is we have provided a little bit of teeth through the KLSE listing rules by requiring disclosure of compliance,' says Nik Ramlah.

Still, there might be another reason why Malaysia has decided to take the voluntary approach. There has to be a balance between what's prescribed and what's not as there are costs involved.

KLSE's Legal Advisor (Listing), Selvarany Rasiah, emphasises that the exchange is mindful of over-regulation when introducing new listing requirements, which is why it engages in consultation with industry before implementing them.

'We want to make sure there is buying in. That is why we are very careful in not making everything prescriptive, which would add to the costs of doing business,' she says.

Remedying inconsistencies

Even so, there are inconsistencies between the Code and the KLSE listing rules and isn't there a need to rectify this?

According to KPMG's Chandran, there is a disconnection between the requirement for disclosure in the Code and the listing rules. He notes as a 'classic example' the disclosure of directors remuneration, in which the Code recommends details of what each director earns but the listing rules state that the remuneration can be disclosed in bands of RM50,000.

Although Selvarany doesn't think there is such a disconnection, she agrees that it could have been a cause for confusion for the industry.

She says the distinction between the Code and listing requirements is that the former is activational in nature and sets out the ideal, whereas the latter provides the minimum that is applicable to all companies.

'Should we then make certain items in the Code mandatory? But, as I have mentioned, corporate governance itself is evolving. As far as the regulators are concerned, we would be undertaking a continuous review of the rules that we have put in place to ensure that it can meet the needs of the investing public and the capital market,' she says.

On the disclosure by companies on their application of the Code, the exchange feels that companies have put in a lot of effort in the area.

'We find that companies in fact do go to great detail in describing corporate governance, which is good because then it means they are not taking a checklist approach,' says Selvarany.

Teo Ee Sing, from the Malaysian Advisory Committee of the Association of Chartered Certified Accountants, echoes her sentiments. As one of the judges for the inaugural Malaysian Business Corporate Governance Award 2002, he says the majority of annual reports reviewed for the award displayed a high level of compliance.

'Whilst the public-listed companies cannot be faulted for compliance, it is felt that further voluntary disclosure would display a heightened understanding of the true essence of good governance,' he says.

Investors are becoming increasingly discerning and more directly

involved and Teo feels that they will use the right and reliable information more effectively for the sake of protecting and enhancing their long-term interests.

In the final analysis, a complete and trustworthy information system will not only rest on governance responsibilities, but on the right behaviour on a voluntary basis.

As CLSA Emerging Market rightly puts it in its latest corporate governance report, 'No system of rating companies for corporate governance will be perfect. The risk is assessing and scoring for form rather than substance.'

Learning from past mistakes

Going forward, the SC will give more attention to risk management, which is one important component of the Code.

Says SC's Nik Ramlah, 'What the SC is trying to do now is to focus on the need for people to realise that they need to think about risk management, they need to spend more time and perhaps more effort in looking at risk management because the nature of businesses changes.'

Certainly, there are more risks to manage now compared to 20 or 30 years ago, such as market risk, legal risk and currency risk. Hence, risk management becomes even more important and complex.

'So companies ought to focus on the issues of risk management but those are already inherent in the core values of good corporate governance,' she adds.

Understandably, laws and compulsion can do only so much to stop the crooked mind. Therefore the hybrid approach - the choice of the greater majority today - may be the right path. There is wisdom to compel disclosure on practices that are voluntary in nature so that there would be greater acceptance in the long term.

Ultimately, the challenge is not only for the rules and regulations to be enforced without fear or favour, but for the directors to be continuously educated and reminded that there is no short cut in building and managing a business for the interests of all stakeholders.

Yet, there is another obstacle for the market participants to face in the nearer term. With the equity market on the uptrend in recent weeks, investors as well as the listed companies may forget the past, as most usually do, and succumb to the temptation to throw caution (in this case the Code) to the wind.

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