

**SPEECH BY TUN DR MAHATHIR BIN MOHAMAD
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**“How Corporate Governance can take Malaysia
to the next Economic Level”**

1. Firstly I would like to thank the organisers for the invitation to speak on this very difficult subject of Corporate Governance and the future of Malaysia.
2. Today's business involves more and more corporations which at times can be bigger than the Governments of many states or nations. Indeed some of the corporations are so big that they can overwhelm Governments. We read of the Banana Republics where Governments have become dependent on the corporations which own and manage large banana plantations.
3. But it must also be admitted that some of these large corporations can play very significant roles in the development and enrichment of whole countries. A Government that is skilled in managing these huge corporations obviously stands to gain a lot from their wealth-creating activities. The gains can contribute to the development of the nation.
4. To ensure that this contribution to the nation's development would take place, it is important that the Government should provide reasonably good rules, regulations and laws for the administration and management of corporations.
5. The structure of Corporations and their Governance must thus conform to certain regulations and requirements determined by Government. However in this the Government has to be judicious. Too strict or too tight regulations might very well result in the corporations migrating to more friendly environments.
6. In a way Malaysian Government regulations have exhibited an understanding of the need for corporations to be well administered. The conditions set by the Government to attract foreign investments are good examples of this. Since the corporations were foreign we did not seek to have close oversight of their management. All that was required of them was to create jobs for our people.
7. But since then more and more Malaysian companies have emerged and grown into large corporations. Their governance became a matter of concern for the Government. It is very easy for these corporations to raise funds from the public and misuse the funds. For example funds may be raised to set up a business and after enough funds had been accumulated the company may just vanish or go bankrupt. The funds would just disappear.

8. For this reason the setting up of businesses and the raising of capital must conform to set rules. Records of business and accounts have to be properly kept so as to ensure the safety of shareholders' funds and the payment of Government taxes.

9. Assuming that the businesses were properly set up, there would then be the problem of how it is managed. In Malaysia a board of directors and a management team would be necessary. Now we have independent directors on the boards.

10. A lot of skills would be needed to ensure the corporations would be run well. If proper records are kept of all transactions then it would be possible to detect early if something untoward was happening.

11. In the case of the pyramid schemes we have seen how huge funds were apparently set up and extraordinary profits paid out. It would take a long time before the abuses would be discovered. There is here an obvious failure on the part of governance of the business.

12. Systems can be introduced to help prevent fraud but in the end it is the character or culture of the players which would determine the success or otherwise of the corporations. Such is the role of culture that some people or some countries would find difficulty in attracting investment even by their own nationals because of corruption and abuses which these people are reputed for. When people are known to be untrustworthy or corrupt, then corporations set up by them no matter what the structure is will just not prosper.

13. In corporate governance therefore, trustworthiness is an important asset. If the people sitting on the boards or managing the corporations are trustworthy, half the problems of governance would be resolved.

14. People, managers as well as workers sometime take trust lightly. Taking money from petty cash or taking stationery belonging to the company may not bring down the corporations. But they will all undermine the company because they can lead to more things being removed which belong to the company. Records might be photocopied and sold. Bigger and bigger sums might be offered for more things.

15. In good times these may not be noticed but when business is bad, the losses may add up to a considerable amount, enough to drag down the company.

16. In all these the leadership or the head is important. If he is seen to take things which do not belong to him, others would follow suit. And when everyone starts taking things which do not belong to him, the performance of the corporation cannot be good.

17. We are seeing today scandals involving bonus to the managers. Because this is based on the quarterly performance of the company, the tendency is to paint glowing pictures which would justify huge bonuses, stock options etc. In the end the true performance would be revealed and the corporation could go bankrupt.

18. Corporate governance is therefore an important part of the performance of a corporation. In this the Government must play a role by instituting the right regulations and in overseeing the performance of corporations.

19. The management from the CEO to the most junior executive must play a role to ensure that proper management techniques are employed.

20. And above all the culture of the corporation, if not the culture of the people as a whole must abhor dishonesty. Even the smallest breach of the accepted practice must not be tolerated.

21. Loyalty to the company must be instilled in everyone. This will depend on the skills of the CEO and the executives to manage human resource. Reward systems can contribute.

22. I will not be able to elaborate on everything which constitutes Corporate Governance. But there can be no doubt that it would contribute toward the success or failure of an enterprise or a corporation.

23. A corporation can be regarded as a citizen of a nation. Its success must therefore contribute to the development of the nation. It is therefore important for the Government to ensure the success of the governance of corporations.

24. That was why we decided on the Malaysia Incorporated concept. The Government has a duty to ensure the success of the corporations simply because in Malaysia 25% of the profits belong to the Government. But besides this the corporations contribute to job creation, and therefore to the disposable incomes of the workers. In turn the purchase by workers at all levels would enrich all kinds of retail and wholesale business. These business would in turn pay taxes to the Government, apart from themselves creating jobs for all kinds of people.

25. The revenue earned by the Government would be expanded on infrastructure for example. The expenditure on building infrastructure would also create business opportunities and jobs again for a whole lot of people. Provision of adequate infrastructure would contribute to the development of the nation.

26. When corporations are well managed and profitable the revenue of Government through corporate tax must increase. This obviates the need to

borrow or at least reduce the need to borrow. Many of the countries which have only small business cannot collect much by way of taxes. We see these countries having to borrow from foreign source. This would be a drag on the country especially when the incomes of Government cannot service or repay the loans. Such countries obviously cannot grow.

27. I have mentioned earlier of the role of FDI. Their main contribution was the creation of jobs. No taxes were paid by them. But much knowledge was gained from FDI and to a small extent they enrich and develop the country.

28. We may notice that some of the North East Asian industrialising countries did not depend so much on FDI. Instead they acquired foreign technology and initiated their own corporations which made use of the technology to produce manufactured goods. We may have noticed that their growth is much faster than our growth. We had to have FDI because early on we lacked capital, technology, management skills and knowledge of the market. FDI has served us well.

29. But now it is time to follow the strategy of the fast growing newly industrializing countries. We now have the capital, the know-how, the management skills and understanding of the market. We must therefore set up our own corporations in all fields.

30. In the fast industrialising countries, invariably the Government would extend help in the form of cheap loans, reduced taxes, speeding up approval etc.

31. It is necessary that our companies be big and able to compete in the market. The initial help extended by the Government would soon be recovered.

32. As an example an investment of roughly 500 million Ringgit plus a soft loan of 800 million in Proton has actually enabled Government to collect almost 20 billion in taxes of various kinds from the sale of Proton cars in a 10-year period. The loan has been repaid.

33. But Proton also provides a good case study of corporate governance. Initially the 100,000 car capacity plant was managed by Malaysians entirely. The Board was Malaysian and the CEO and other executives were Malaysian.

34. Proton failed, not being able to sell even 25,000 cars. Huge losses were made. After it became apparent that neither the board nor the management were effective, a Japanese CEO was appointed. Japanese work ethics and systems of management were introduced. Standards improved and very quickly a turn around was achieved.

35. Malaysian managers were placed under the Japanese to understudy them. Eventually the Malaysians took over. Using much of the Japanese kind of management, the performance continued to be good.

36. Then Proton was sold to a private company and the CEO was changed. This CEO has vast experience in the management of other business. Under him the performance of Proton improved tremendously. At one stage the company had 4 billion Ringgit in cash as sales shot up to over 200,000 cars per year.

37. Then it was decided that the CEO should be removed. In the governance of Proton the role of the owners and the directors was not clear. Could the owners arbitrarily remove a CEO, especially one that was successful?

38. But the CEO was on contract. There was no reason for the board or the Chairman to remove the CEO. So a reason had to be created. The new contract offered was far below the expectations of the CEO. Failure to reply to the offer was then cited as cause for not renewing the contract. It was an example of constructive dismissal and bad governance.

39. Later the case went to the industrial court and there it remained until today.

40. In the meantime although the management of the company was the responsibility of the CEO, the Chairman decided to become an executive chairman against the provision of the governance structure of the company.

41. The result was a rapid decline of the company. Hundreds of millions of Ringgit were lost as the Chairman literally managed the company over the head of the CEO.

42. Assets worth several hundred million Ringgit were sold for a paltry four Ringgit in order to save losses or so it was explained. Investments in research and development were stopped.

43. Eventually the Chairman was replaced by a new Chairman by a process that is more political than the provisions of company governance.

44. There is nothing wrong with the system of governance of the company. However when owners and politicians were allowed to exercise rights which were not provided for the Governance of the corporation the result was to relegate corporate governance to the back-burner.

45. With the roles of the new Chairman clarified, and the executive authority returned to the CEO, Proton has begun to make a recovery.

46. The case of Proton provides a fine example of the importance of corporate Governance in the structure of management of a corporation. The roles of the shareholders and owners, the board with its independent directors, the Chairman of the Board and the CEO needs to be carefully adhered to.

47. In Government companies, the so-called GLC corporate governance is very often ignored. Various people including Governmental heads and family members as well as cronies are often allowed roles not provided for.

48. On the top of this governance does not provide for transparency, or if provided for are ignored. Government power is often used to steamroll decisions and to brush aside the interest of others. Requisitions are made not through proper bids but by the assumption of Government power.

49. The private sector finds itself at a disadvantage. Some are made to surrender shares without due compensation. Others are denied access to projects as the GLCs arbitrarily assumed rights not provided for. Then the GLC may actually fail to implement the projects they have taken over.

50. This disregard for corporate governance has lead to anarchy and loss of confidence on the part of the private sector. The growth of the economy cannot but be stunted because of this.

51. If Corporate Governance is to take Malaysia to the next economic level then the role of corporate governance must be respected and honestly practiced.

52. We see this in Petronas. The structure of Petronas, as a corporation with its system of corporate governance is clearly respected. Although it is 100% owned by the Government the Government never interfered with the management of the corporation.

53. Petronas reports only to the Prime Minister. The Prime Minister can suggest certain lines of action but does not interfere with the way Petronas carried out the proffered advice.

54. Petronas has a board on which sits Government representatives as well as industry savvy directors and independent directors. The board takes no part in the management of the corporation but receives comprehensive reports of the performance of the company. Should the board feel a need to criticise the management or to advise it, the board would convey this to the CEO and the management representatives on the board. Beyond that the board has no role.

55. Of course if there is any serious breach or failure or losses the board can recommend to the Government the removal of the CEO. But since Petronas appears be well-managed and profitable the need for this had not arisen.

56. The length of the contract of the CEO is fixed. Should he fail to deliver then the board would be within its rights to not extend the contract.

57. Because the governance of Petronas was strictly adhered to, this, the biggest corporation in Malaysia, had proven very profitable. The return to Government over a period of almost 40 year was more than 400 billion Ringgit, of which 270 billion was paid to the Government as dividend in the last five years.

58. Clearly good Corporate Governance of Malaysian corporation can contribute much to the prosperity and development of Malaysia. As much as these corporation needs to be well managed, they do need Government support. This can take the form of exemption from taxes, soft loans and willingness of the Government to buy the products if they are of good quality.

59. With good Corporate Governance and reasonable treatment by the Government, Malaysian corporations can really help take Malaysia to the next economic levels.
