Can Good Corporate Governance Practices Improve Firm Financial Performance?
A Survey on the Perceptions of CEOs in Malaysia

Abstract

This paper discusses the findings from interviews with CEOs of Malaysian Public Listed Companies. Thirteen CEOs were interviewed to achieve this purpose and these were carried out between 2002 and 2004. These interviews were designed to document the views of Malaysian CEOs on the standards of corporate governance in Malaysia with a view to suggest reforms and also, to strengthen the findings obtained from the empirical study of 120 companies that was analyzed previously. A broad spectrum of topics were discussed and this include the Malaysian legal framework and the issue of enforcement, prevalence of selective prosecution, the effectiveness of the recently introduced Code of Corporate Governance, the prevalence of family dominated companies, protection of minority shareholders, management integrity and reluctance to change. This paper also included the findings on the empirical study on corporate governance practices in Malaysia covering areas such as board structure and practices i.e. the role of non-executive directors and the issue of board independence, duality structure of CEO and Chairman of the board of directors, the impact of concentrated ownership, the role of audit committees, institutional investors and banks in corporate governance. The findings of this study indicate that the standard of corporate governance in Malaysia fell short of expectation especially in terms of minority protection and law enforcement. It was also found that good corporate governance practices cannot be relied upon to improve firm performance. A complex multitude of factors contributed to the weak linkages.

Introduction

This paper is the product of a series of interviews with chief executive officers (CEOs) of Malaysian public listed companies (PLCs). The interviews were conducted as a follow-up on an earlier empirical study of 120 companies. The econometric analysis in that study showed that most corporate governance practices, such as the presence of non-executive directors, independent audit committees, institutional investors and concentrated ownership have no bearing on corporate earnings. However, the only exception is that a dominant CEO (a CEO who is also the chairman of the board) could improve company's earnings substantially. Consequently, the interviews were designed to uncover the underlying reasons for the results obtained from these empirical findings.

Definition of Corporate Governance

Numerous definitions are found for corporate governance. In Malaysia, corporate governance is narrowly defined by Khas (1999) of the Malaysian Institute of Corporate Governance as: “A system which determines how an enterprise is governed and controlled. It comprises the internal and external (processes) of the enterprise, management accountability of its authority and agency through an effective internal control system and legislation, market control for disclosure of corporate information and transparency of the company's affairs”. A broader and more encompassing Malaysian definition is provided by Noordin (1999). He asserts: “Corporate governance is mainly about accountability and transparency. It is how the enterprise presents itself transparently to the wider world outside the organisation - to shareholders, potential investors, employees, regulators and other interest groups with a legimate interest in its affairs. It is also about disclosure which relates to stewardship and control, and the emphasis on the company to promote the development of the best practices in corporate governance”. Finally, a concise definition which incorporates a long-term goal is given by the Malaysian High Level Finance Committee (1999); which defines 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. All these Malaysian definitions seem to emphasize corporate accountability and transparency. These were the prime issues at the heart of the Asian Financial Crisis of 1997/98.

Literature Review

The importance of the board of directors arises as a result of the dispersion of ownership in today’s modern corporations, which rely heavily on the external sources of capital. Hence, the owners of the firm are no longer the ones responsible for deciding the direction and the daily operation of the firm. Rather, the daily operations of the firm are in the hands of a team of professional managers who, at best, own a negligible amount of equity. This separation between ownership and control in today’s modern companies has resulted in a potential conflict of interest (Berle and Means, 1932). In the agency theory, it is argued that when the management interest is low, there is a greater likelihood that the management involves itself in value-decreasing activities (Jensen and Meckling, 1976). The predicted reduction in value of the firm as a result of the management opportunistic behavior is termed as the ‘agency costs’ (Jensen and Meckling, 1976). The creation of a board of directors is to monitor the performance of the firm so that the interest of the shareholders is protected (Kosnik, 1987, 1990). Empirical results suggest that boards in widely held banks in Asia are likely to be smaller and more independent, consist of fewer politicians, more clearly separate the functions of the chairperson and CEO, and provide more professional bank leadership (ADBI, 2006).

Board of Directors & the Issue of Independence

Two conflicting views are offered in the literature with regard to the effectiveness of the corporate boards of directors. One of the views is based upon the managerial "hegemony" and the other is the agency theory. According to the hegemony theory, the board of directors is argued to be incapable of fulfilling its overseeing role and of protecting shareholders' interest (e.g. Kosnik, 1987; Mace, 1986). The view argues that management dominates the boards of directors and, hence, they "… act merely as ceremonial rubber stamps" (Mallette and Fowler, 1992). Reservation about the effectiveness lies primarily on the appointment of outside directors on the corporate boards which determines the board's monitoring and oversight roles. Factors identified by Koontz (1967) included the fact that boards were created by CEOs who selected and recruited directors who could go along with him or her and a shortage of competent directors.

Herman (1981) and Mace (1986) argue that outside directors were valued for their ability to advise, to solidify business and personal relationships, and to send a signal that the company is doing well rather than for their ability to monitor. Mace (1986) further argues that in selecting outside directors, the title and the prestige of the candidates are the primary consideration. Further, he maintains that CEOs dominate the director selection process and therefore control the board. Vancil (1987) and Waldo (1985) are also skeptical about the ability of outside directors to make independent judgments on firm performance due to the dominant role played by CEOs in selecting outside directors. Keasy and Wright (1993) raise concerns about outside directors' effectiveness to supervise management, their independence and the number of available qualified individuals to become directors. In a similar note, Stiles and Taylor (1993) are also concerned about the quality of directors due to the limited pool of potential talents to serve as independent directors.

The agency theory, at the other end of the spectrum, argues that the presence of boards of directors is to monitor the management and to protect the interest of the shareholders (Mallette and Fowler, 1992; Fama and Jensen, 1983). It is further argued outside directors are stricter in discharging their responsibilities, as they are not directly affiliated with the management (Weisbach, 1988). Having outside directors, who are argued to be impartial, is vital as they can act as "… providers of relevant complementary knowledge" to the management (Fama and Jensen, 1983, p. 315). Hence, outside directors could bring into the board the wealth of expertise that is useful to the management in deciding the direction of the firm or to clarify its strategies. This could further enhance the boards' roles as being the ratification and the monitoring of management decisions, as argued by Fama and Jensen (1983). As a result, the performance of the management is expected to improve, and more importantly, increase the wealth of the shareholders.

To test the monitoring incentives of outside directors, studies have focused on crisis situations, such as the firm's continuing poor performance (e.g. Kini *et al.*, 1995; Weisbach, 1988) and the incident of greenmails (e.g. Kosnik, 1987). It was argued that outside directors' incentives to monitor and to discipline management on behalf of the shareholders were high. Their evidence supports the arguments where the extent of outside directors making up a board determines the management turnover, and the eventual success (or failure) of a greenmail attempt. In addition, evidence has also showed that outside directors are more likely to join, and inside directors leave, the boards of poorly performing firms (Hermalin and Weisbach, 1988). Thus, it may be argued that poorly performing firms are expected to benefit from the entry of more outside directors. In a study on the extent of fraudulent reporting, Beasley (1996) further documented evidence supporting the significant roles of outside directors. Evidence of outside directors' effectiveness was also documented in New Zealand by Bradbury and Mak (2000).

However, in a Malaysian study, Abdullah (2004) found that neither board independence, leadership structure nor the joint effects of these two showed any relations with firm performance. In another Malaysian study, Haniffa and Hudaib (2006) similarly found that there is no significant relationship between the proportion of non-executive directors on the board or and corporate performance. In the same study, similar results were recorded for role duality.

CEO and the issue of Duality

The board of directors, argues Jensen (1993, p. 862), is "… at the apex of internal control system, has the final responsibility for the functioning of the firm." However, when the board chairman is also the CEO, the board intensity to monitor and oversee management is reduced as a result of lack of independence and a conflict of interest (Lorsch and MacIver, 1989; Fizel and Louie, 1990; Dobryzynski, 1991; Millstein, 1992, Daynton, 1984). The issue that arises when companies practice CEO duality is "Who monitors management?" This is best expressed as, "*custodias ipso custodiet*" or "who will watch the watchers." Unlike in a two-tier system, the unitary system has the board at the highest internal control system, as argued by Jensen (1993). It has been argued that the firm's managers' influence in setting board agenda and controlling information flows could impede the board's ability to perform its duties effectively (Solomon, 1993; Aram and Cowan, 1983). The firm's managers' ability to determine the board agenda and the flow of information is predicted to be much stronger when the board chairman is also CEO than when the firm adopts a non-dual structure. Daynton (1984) asserts that the board is the primary force pushing the company towards realizing the opportunities and meeting the obligations to the shareholders and other stakeholders. He argues that it is the CEO who enables the board to play the primary force.

In a similar vein, dual leadership structure "signals the absence of separation of the decision management and the decision controls" (Fama and Jensen, 1983, p. 314). Rechner (1989) argued that the ideal corporate governance structure is one in which the board is composed of a majority of outside directors and a chairman who is an outside director. She stated that the weakest corporate governance is one where the board is dominated by insider directors and the CEO holds the chairmanship of the board. When one person dominates a firm, the role of independent outside directors becomes "hypothetical" (Rechner, 1989; Daynton, 1984). Rechner (1989, p. 14) claimed, "… this structure is likely to function as a rubber stamp board given the total control of the CEO." A structure of this type is likely to lead to the board being incapable of protecting the interest of the shareholders. The board, with the high influence of the management, will not be able to discipline the management appropriately as the management who controls the board will over-rule such initiatives. Miller (1997) also argues that a non-executive chairman promotes a higher level of corporate openness.

The issue of separation of the top two posts has been addressed in the Cadbury Committee (1992), which recommended that the roles of the board chairman and the CEO be separated. The Malaysian Code on Corporate Governance (2001) also recommends a similar board structure. The reason for the need for separation is that when both the monitoring roles (i.e. the board chairman) and implementation roles (i.e. the CEO) are vested in a single person, the monitoring roles of the board will be severely impaired. The impairment in the board independence could affect the board incentives to ensure that management pursues value-increasing activities. The Hampel Report (1998) points out that, in some circumstances, the top two roles can be combined, but it recommends that the reasons for combining the roles be publicly disclosed.

Though the literature seems to consistently argue that separate individuals for the post of CEO and chairman leads to a better corporate governance system, the real issue is whether this leads the board to be a better monitor and, thus, is capable of increasing the value of the firm. Proponents of the CEO duality structure argue that combining these two roles provide a clear focus for objectives and operations (e.g. Andersen and Anthony, 1986; Stoeberl and Sherony, 1985). Separation of CEO and chairman posts has both costs and benefits and it was shown that, for larger firms, the costs are greater than the benefits (Brickley *et al.*, 1997). Evidence by Abdullah (2002) in the Malaysian setting and Bradbury and Mak (2000) in the New Zealand setting confirmed the cost and benefit contention. In their study, Berg and Smith (1978) found that there was no significant difference in various financial indicators between firms, which experienced CEO duality, and firms which did not. The substantial cost of the separation could come from "… the incomplete transfer of company information, and confusion over who is in charge of running the company" (Goodwin and Seow, 2000, p. 43). This could hamper the performance of the firm's financial indicators. It could also be argued that when one person is in charge of both tasks, the decisions are reached faster. Moreover, when the board chairman and the CEO are the same person, he or she is well aware of the decisions needed to improve the performance of the firm. In another study, Chaganti *et al.* (1985) also documented evidence similar to that found by Berg and Smith (1978) involving firms that experienced bankruptcy (failure) and survival. Rechner and Dalton (1991) also showed that firms with CEO duality consistently outperformed firms with a CEO non-duality structure, which contradicts the expectation.

The Concentrated Ownership Structure

As regards the relationship between ownership concentration and firm performance, empirical results in the United States are inconclusive. Demsetz and Lehn (1985) found no significant correlation between ownership concentration and profit rates for 511 large corporations. Morck, Schleifer and Vishny (1988) report a piecewise linear relationship of Tobin's Q with board member ownership for 371 Fortune 500 firms, and also found evidence of an inverted "U"-shaped relationship between the degree of ownership concentration and profitability. Stulz (1988) demonstrates that higher managerial ownership can insulate managers from external takeovers, and by allowing managers to block takeover bids, can lower firm value. Morck *et al*. (1988), McConnell and Servaes (1990, 1995), Hermalin and Weisbach (1991), and Holderness, Kroszner and Sheehan (1999) all establish that the value of a firm rises from a base of low level of managerial ownership and to fall with higher level of managerial ownership. Some empirical research on the impact of large owners on managerial compensation has provided evidence to support the notion that managerial opportunism persists in the absence of owners large enough to enforce their own interests. For example, firms with large owners as compared with firms without large owners, restrict the residual loss of companies arising from excessively high managerial compensation (Dyl, 1988), compensate their chief executives more for performance than for compensation scale based on years on the job (Gomez-Mejia, Tosi and Hinkin, 1987); engage in increased CEO compensation monitoring and incentive alignment activities (Dyl, 1988; Tosi and Gomez-Mejia, 1989), and following major acquisitions, reward CEOs more for performance than for years on the job (Kroll, Simmons and Wright, 1990). In a study of 127 Chinese companies listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange for the period 1993 to 1995, Xu and Wang (1999) found a positive correlation between ownership concentration and a firm's performance. They suggest that large legal person shareholders have the incentive and the power to monitor and control the behavior of the management and play significant role in corporate governance. Some studies suggest a partial market for control, and point to a little relation between ownership concentration by institutions and holding companies, and disciplining (Renneboog, 2000; Agrawal & Knoeber, 1996). Ruhani and Sanda (2001) found that ownership is significantly related with performance, tending to rise at early levels of insider ownership and to fall at levels of ownership beyond 36.7% of firm's equity. Their results are in agreement with those of Mat-Nor, Said and Redzuan (1999), Wong and Yek (1991) and Tam and Tan (2007). Similarly, Faizah (2002), who investigates whether ownership structure has significant effects on the performance of plantation companies listed on the KLSE, reports a positive correlation between ownership concentration and firm performance as indicated by market-to-book value ratio. A recent study by Haniffa and Hudaib (2006) produced mixed results; accounting performance measure suggests better performance with concentrated ownership while the market perceives otherwise. Chu and Cheah (2006) found that ownership structure is able to extract cost and benefits from governance structure, and that ownership identities influence asymmetric information and risk.

The Governance Role of Audit Committees

Several empirical studies in accounting have focused on the voluntary formation of audit committees to identify factors affecting an entity's decision to create an audit committee directly responsible for overseeing the financial reporting process (Pincus, Rusbarsky and Wong, 1989). Collectively, these studies suggest that larger companies, which are audited by very large auditing companies and which have bigger boards with greater representation of outside directors, are among the companies more likely to voluntarily form an audit committee. Several studies document that the presence of an audit committee is associated with fewer incidences of financial reporting problems. For example, McMullen (1996) finds that entities with more reliable financial reporting, such as those with absence of material errors, irregularities and illegal acts, are significantly more likely to have audit committees. De Chow, Sloan and Sweeney (1996) show that firms subject to the enforcement actions of a government regulator are less likely to have standing audit committees. Carcello and Neal (1999) find that the likelihood a company in financial distress will receive a going concern modified auditor's report is lower when the percentage of inside or grey directors on the audit committee is higher. These findings suggest that the independence of the audit committee may affect the objectivity and independence of the external auditor.

A Malaysian study by Zulkarnain, Shamsher, Hamid and Nasir (2001) suugests that chairmans of the audit committee rated their own effectiveness attributes relatively higher than the internal auditors. This implies that chairmans perceive the audit committee as fairly competent in reviewing, analyzing and evaluating matters concerning audit, non-finance matters and the accounts of the company. Secondly, they also found that the audit committee has doubts concerning the committee members' technical skills. Thirdly, the internal auditors in these companies believe that the audit committee lacks the experience and technical skills to effectively perform internal accounting and control functions. Another Malaysian study by Mohamad, Shamsher and Annuar (1999) suggests that the internal audit profession is sceptical about the benefits that the audit committee can generate for the company due to their infancy stage of development and the need to prove their effectiveness to the business and financial community. Similarly, Shamsher and Zulkarnain (2001) while investigating the wealth effects of announcements of audit committee formation by main board firms found that significant negative abnormal returns were recorded during the period surrounding the announcement, indicating that investors perceive the mandatory requirement of audit committee as negative news. A recent study by Muniandy (2007) suggests that independent audit committees provide an important check to moderate CEO dominance in firms where CEO duality is present. He further suggests that having more independent directors on the audit committee moderates the auditor's perceived inherent risk when CEO duality is present.

Research Design - Qualitative Method Approach

These interviews were designed to document the views of Malaysian CEOs on the standards of corporate governance in Malaysia with a view to suggest reforms and also, to prove or disprove the findings obtained from the empirical study of 120 companies that was analyzed previously. To better understand the complexity of corporate governance practices, personal interviews were conducted with 13 CEOs of Malaysian PLCs. A qualitative method was used because the issues under investigation are complex and multi-faceted. In-depth interviewing is particularly suited to exploring questions in the human services which relate to the meaning of experiences and to deciphering the complexity of human behaviour (Darlington & Scott, 2002). An interview guide containing a list of topics to be covered during the one-to-one interview is employed**.** The questions posed to the CEOs were open-ended.

In deciding on the number of cases targeted for interviews, directions were gleaned from a number of noted researchers on qualitative research. Eisenhardt (1989) proposes that cases should be added until "theoretical saturation" is reached and a range of between four and ten cases for any qualitative research is enough to generate theory with much complexity and its empirical grounding is likely to be convincing. Similarly, Lincoln & Guba (1985) recommend sampling selection "to the point of redundancy". On the same issue, Hedges (1985) sets an upper limit of 12 because of the high cost involved in qualitative interviews and the quantity of qualitative data which can be effectively assimilated. In the same vein, Miles & Huberman (1994) suggest that more than 15 cases make a study "unwieldy". Perry (1998) suggests that the widest accepted range seems to fall between two to four as the minimum and 15 as the maximum.

Twenty-eight CEOs of PLCs were approached for interviews. Thirteen CEOs agreed to be interviewed while fifteen declined. The reasons given for declining are; the CEOs were too busy, company policies forbids giving interviews to outsiders and corporate governance issues are too sensitive to be discussed. Three senior officers (other than the CEO) who declined to be interviewed gave reasons that they do not have the official clearance to talk to people outside the organization. Such a stand reflects the prevalence of fear in disclosing information in the country. The companies that were included in the interviews came from Kuala Lumpur and around its suburbs (Petaling Jaya, Subang Jaya, Puchong) and Kuching (the capital city in East Malaysia). Eleven of the companies are from the main board (with a minimum issued share capital of RM60 million or US17.2 million) while two are listed on the second board (with a minimum issued share capital of RM40 million or US11.4 million). The companies represent a wide cross-section of the Malaysian business sector, namely consumer products (2), industrial products (3), trading (3), services (3), plantation (1) and finance (1). Although these companies were selected randomly, there is the need to secure a wide variety of views from as many sectors as possible. The underlying principle used in the sample selection is the need to obtain information rich cases, that is, cases worthy of in-depth study (Patton, 1990). In order to secure the depth required, only senior managers or above were targeted. In order to extract frank and open opinions, interviewees were told at the start of the interview that names of organization and interviewees would be kept secret and that it is important for them to give their personal views instead of the organisation's stand on the issues discussed. Since the subject matter is very sensitive, only three of the 13 interviews agreed to have the discussion audio-taped. This is because tape recording is always controversial and is rarely approved during interviews in Asia (Perry, 1998). Those interviewed were managing directors (4), executive directors (4) and general managers of finance or compliance (5). Each interview lasted about one hour and discussions were held at their respective offices during office hours. Three of the respondents were interviewed between December 12, 2002 and January 3, 2003, while the other ten were interviewed between June 15, 2004 and July 1, 2004.

Findings on Standard of Corporate Governance in Malaysia

When asked on their views on the standard of corporate governance in Malaysia, all the CEOs interviewed agreed that it is below par, and needs improvement particularly from the relevant authorities. All the CEOs are of the opinion that the rules governing the country's corporate governance practices are very good in protecting shareholders and image of the market. The problem lies in the enforcement of these rules and the reluctance of company management to change old attitudes. One of the CEOs interviewed puts it bluntly: "We have first class rules but third class management. Management integrity is lacking". Another CEO adds: "Even with comprehensive laws in place, the country's corporate governance practices are still behind many developed countries. There is selective persecution and lack of transparency". On the contrary, a CEO of a large PLC described the Malaysian code on corporate governance to be tougher and better codified than some advanced countries or our neighbour, Singapore. This view is however, not shared by six other CEOs. In fact, a CEO of a PLC said: "KLSE rules are being twisted to the advantage of certain big corporations. Influential people could seek changes to the rules. 'Goal posts' are conveniently shifted to suit individual needs (i.e. rules are conveniently changed so as to benefit certain groups or individuals). Government linked companies are given much leeway by the Securities Commission".

Only one CEO mentioned that the rules are being applied fairly. Another CEO mentioned that good corporate governance practices have not yet been accepted as the right way of doing business in this country. In his opinion, corporate culture in the country has been dominated by management putting too much emphasis on making money and too little on corporate governance issues. A majority of the CEOs interviewed (62%) indicated that their companies have a code of best practices. In addition, all the CEOs indicated that they follow the Malaysian code of corporate governance issued by Securities Commission (S.C.). However, a CEO of a large PLC perceives it to be more in form rather than substance, and adds that many companies seem to follow the rules blindly. Two CEOs expressed dissatisfaction with the recent requirement for PLCs to report their financial results quarterly as they feel it is costly, burdensome and unnecessary. They felt that the Securities Commission is over-reacting to concerns about inadequate disclosures in Malaysia.

On the Issue of Protection of minority shareholders

All the CEOs agreed that there is a need for greater protection of minority shareholders. The CEOs are also unanimous in pointing out that there has been much improvement in recent years but added that there is still much room for improvement. A CEO of a large PLC stressed: "Stock prices are set by minorities and not the majority. The majority do not trade often on the stock market". There seems to be a realization among the CEOs interviewed that minorities including institutional investors are now becoming more active in voicing their grievances over unfair corporate practices. In addition, three CEOs agreed that minority shareholders have been exercising their power by voting against management proposals and driving down share prices of many companies on Bursa Malaysia.

A large portion of the CEOs interviewed (77%) believed that the Malaysian corporate sector is still very much dominated by powerful families who have little regard to the rights of minority shareholders in their companies. The company is treated as an extension of their own. The CEOs believed that minority protection laws are available but there is only minimum protection. One of the CEOs stressed: "The minority does not have much forum to voice their concerns. The annual general meeting (AGM) is just a formality with little serious discussions. The majority can pull through any decisions. There is a need for media hype and certain pressure groups to get certain issues resolved".

Findings on Corporate Governance Practices

Board of Directors & the Issue of Board Independence

The interviews on CEOs reveal that the nomination committee plays an active role in the appointment of directors to the board. On the other hand, companies that do not have a nomination committee would appoint directors through the board. All the CEOs interviewed responded that board members participate actively in board deliberations and that all directors have access to sensitive information. In addition, the directors can engage experts to advise them and these expenses can be charged to the company. Such board practices looked good. However, the econometric analysis reveals that Malaysian firms have not responded positively to the presence of non-executive directors. The interviews of CEOs revealed many reasons. First, and foremost, the interviews reveal that about 54% of the boards of directors of the companies were dominated by insiders with outsiders making up about one-third of the board. The reason for this phenomenon, according to a CEO, is due to the fact that these companies were family-owned prior to their public listing. Company records show that control of the company is still very much concentrated in a few family members who hold large blocks of shares. Considering that most of these are large public listed companies, this is rather ironic since it signals that most companies are not yet ready to admit independent directors who may perform a value-enhancing role. This is because independent directors tend to oppose management. On the issue of director's independence, a CEO feels that none of the directors can be completely independent because, as he puts it: "We cannot just simply take someone from the street and appoint them to the board. We do expect a certain amount of loyalty to the company".

A second reason why non-executive directors are ineffective is the lack of skills required to contribute to firm performance. From the interviews, it was found 54% of the PLCs indicated that skills or knowledge of industry are not important factors for consideration when selecting board members. However, the CEOs mentioned that special skills such as knowledge of law and accounting are considered useful. The justification for bringing in directors with unrelated skills is that they can bring different perspectives on issues put to the board, and that if directors' skills are concentrated in one industry, it may lead to lop-sided arguments. This may sound reasonable, especially when these unrelated skills include finance, legal and accounting. Such skills seemed useful in the light of the many rules and regulations introduced recently by the authorities, such as a recent ruling requiring the audit committee to be staffed by at least one member with an accounting qualification. These companies seemed to be more concerned complying with the rules than selecting directors who have the technical skills to contribute positively to performance. This is another important reason why non-executive directors do not contribute to firm performance. They simply do not understand the business well enough. It seems that only minimal knowledge is required from the non-executive directors and this relates to mere compliance with law and accounting regulations. Specialised knowledge required to contribute to profitability is not an important consideration. This is especially true in government owned companies. A CEO of a large PLC states: "Companies with a majority of independent directors are usually government owned. Their boards are dominated by ex-government servants or politicians who do not know the business well, are not innovative and are usually inefficient".

A third possible reason contributing to the ineffectiveness of the non-executive directors is due to the limited role they can play. The survey reveals that 54% of the companies do not have a nomination committee. According to the literature, such a committee is considered to be crucial not only in selecting new board members who have the necessary skills to perform a value-enhancing role, but to recommend appropriate remuneration to help retain current talent (Klein, 1998; Wright, Matolcsy & Stokes, 2000).

The fourth factor relates to the limited time they spent on company affairs due to their busy schedules. All the companies surveyed have directors who hold multiple directorships. According to one of the CEOs interviewed, this is seen as an asset as it brings benefits through their different exposures in other companies. However, another CEO of a large PLC disagreed. The reason is that it is not possible to remember so many matters put to the board and this limits their contribution to board deliberations.

The fifth reason that could explain the ineffectiveness of non-executive directors is that firm's performance is determined by the company's management that carries out the board policies, not the board itself. This finding seems to indicate that director's role in determining firm performance is not crucial.

CEO and the issue of Duality

All the CEOs interviewed mentioned that the person holding the post of CEO is not the chairman of the board. This is in line with the recommendations of the Malaysian code of best practices which was introduced in March 2000. The econometric analysis on 120 Malaysian companies indicates that combining the positions of CEO and chairman of the board has a positive impact on firm performance. The interviews of the CEOs gave much insight into the reasons such an occurrence in Malaysia.

Firstly, an important factor for the superior performance of dominant CEOs is the speed at which important strategic decisions are made. Most of the CEOs agreed that such a combined structure may give superior performance especially in a competitive environment. One of the CEOs commented: "When the two posts are separate, decision-making process may be slow as proposals have to go through a lengthy process. There are enough checks and balances within the organization to ensure that the CEO does not abuse his position. The logic is that the CEO is probably the largest shareholder in the company and he genuinely wants the company to grow". Another CEO gave a different opinion: "A separate structure with separate persons holding the positions of CEO and chairman could also make quick decisions". Another CEO explains: "This is because the chairman can choose to delegate his authority to the CEO, thus making the CEO dominant in decision-making".

Secondly, a contributing factor to explain the inferior performance of a separate structure as compared to a combined dual structure, is that government linked companies normally have the two positions separate. A CEO of a large PLC puts it simply: "In government linked companies, both the chairman and the CEO are under the direction of top politicians". Consequently, decisions taken are not in the best interest of the company.

Thirdly, according to two CEOs, a significant number of quoted companies are started by the founders who are still very much in control of the company. They dominate almost all important decisions in the company. One of the CEOs commented: "These founders have gut feelings and are prepared to take high risk. Their success can be attributed to their entrepreneurial flair and visionary minds". However, another CEO of a large PLC cautioned that even though such combined structures may give superior performance, their level of compliance with rules may fall short. The CEO explained: "Many good corporate governance practices are sidelined leading to greater tendency for corporate excesses".

Issue of Concentrated Ownership

About half of the companies covered in the interviews seemed to have some form of concentrated ownership. Five of these were family-owned businesses prior to their listing on the KLSE. Four CEOs indicated that concentrated shareholdings are mostly found in family controlled companies and in their opinions, is the norm in the country. A high percentage of CEOs (69%) believed that family controlled companies do not welcome outsiders to sit on their boards and that these companies tend to resist change (as indicated by 54% of CEOs). A CEO commented: "Family controlled companies do resist change but this depends on individuals. These companies have a tendency to reward themselves excessively and may declare high dividends". Another CEO of a large PLC reiterated: "Whether family controlled companies resist change depends on which generation of family members is in charge. The founders who ran a new business welcome change and succeed. It is the second or third generation that usually resists change". Most of the CEOs are also skeptical whether family controlled companies welcome independent directors. A CEO of a family controlled company disclosed that the directors appointed in family businesses are mostly personally related.

Four CEOs are of the opinion that cross-shareholdings are a common practice in Malaysia. A CEO of a large PLC commented: "This method is a way for nominees to control companies without having to disclose the ultimate beneficiaries to the authorities". Another CEO explained along similar lines: "Such a complex shareholding structure could also be used to siphon off profits to their private businesses. These PLCs have initially operated as private companies and have unlimited powers and access to company funds. Subsequently, when they become a PLC, they just go about their business as usual as if nothing has changed. The minority shareholders are the ones that suffer from such bad practices as these companies usually disregard minority interests in their decisions". These findings again raised many questions regarding the state of corporate governance in Malaysia.

The Governance Role of Audit Committees

All the CEOs interviewed revealed that their audit committees consist of a majority of independent directors. The chairman of the committee is also an independent director. The committee is composed of accountants, economists, engineers and professionals in human resource, information technology and finance. At least one of its members has the relevant technical or financial expertise. Six CEOs disclosed that they are not normally part of the committee. However, they do attend audit committee meetings at the request of the committee to answer questions on operational matters. All committee members do not own substantial shares in the company, thereby ruling out any conflict of interest with the company. The findings are in line with the recent KLSE rules for membership of the audit committee (KLSE, 1999). All the CEOs interviewed said that the audit committee takes its tasks seriously and that the board takes a keen interest on the reports of the committee. The CEOs generally agreed that the audit committee improves the company's reporting processes and may prevent fraud in the company. One of the CEOs interviewed said: "The committee is very effective in ensuring compliance with rules and regulations". Four CEOs disclosed that the audit committee can reduce wastage, but a majority (69%) mentioned that it is a management function.

Despite the good corporate governance structures in place in these companies, the results of the data analysis on Malaysian companies indicate that audit committees have no influence on profitability. According to the literature, audit committees can increase the credibility of the financial reporting process by effectively monitoring the internal and external audit functions (Bradbury, 1990). Audit committees usually play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditors' participation in the financial reporting process (Beasley, 1999). Audit committees can, and should, be the corporate participants best able to perform that oversight function (SEC, 1999). In addition, because audit committees meet directly with the external auditor, they potentially improve the quality of information received by the outside members of the board of directors as audit committee members gain more detailed knowledge about the corporation's financial reporting process (Pincus, Rusbarsky & Wong, 1989).

Additional Findings & Insights from the Survey

Role of Institutional Investors

Almost all of the companies interviewed, except one, have institutional investors as their shareholders. Their shareholdings can be quite substantial but usually not a majority share. Those companies which have institutional investors as shareholders, disclosed that Permodalan Nasional Bhd (PNB), State Economic Development Corporation (SEDC), Employees Provident Fund (EPF) and insurance companies as among their investors. A CEO disclosed that there are three types of institutional investors in the country: (1) government owned corporations such as PNB, EPF, SEDC, (2) insurance companies and (3) unit trust funds. The first two are usually silent long-term investors and do not get involved in management decisions. The unit trust funds are short term investors who may block certain corporate proposals that jeopardized their interests.

All the CEOs clarified that institutional investors do not seek board appointments since they are unwilling to participate in company management. If they do, they would risk being labeled as insiders if they trade on the stock market. However, PNB being a long-term investor, do appoint directors in the PLCs that they control as PNB is either the majority shareholder or is the single largest shareholder. One of the CEOs acknowledged that institutional investors are highly knowledgeable managers and would like to receive regular updates on company performance. For this reason, four CEOs mentioned that they do conduct briefing for analysts. A CEO of a large PLC states: "These investors studied company reports thoroughly and ask pertinent questions on company revenues, expenses, accounting ratios, accounts receivables, payables and inventories". Four CEOs disclosed that institutional investors do attend AGMs and ask pertinent questions on company performance. A CEO of a large PLC mentioned: "Our institutional investor contacted us in advance of the AGM; seeking clarification on information published and indicated how they would vote on certain issues".

A small proportion of the CEOs (around 31%) indicated that institutional investors do exert some influence on management. Another CEO clarified: "This is to the extent of their write-ups and threat of share fluctuations". Only three CEOs mentioned that institutional investors keep management on guard and reduces expropriation of company assets. This is because the company's management is keen to retain them as investors. Two CEOs welcomed the presence of institutional investors as they can help to improve share prices through their good advice to management. One of the CEOs clarified: "The objectives of these investors are usually short-term and are interested in companies with potentially high share prices and good dividends potential". All the CEOs indicated that institutional investors in Malaysia do not target poorly performing firms. The interviews reveal that shareholder activism in Malaysia is almost non-existent in contrast to some Western countries. The findings here suggest that institutional investors do not play an active role in matters of corporate governance in Malaysia.

Role of Banks

All the CEOs indicated that their bankers do monitor company performance but do not get involved in issues of corporate governance in the company. The banks are purely concerned about repayment of their loan and interests. All the CEOs disclosed that banks regularly review company's financial statements, give advice and keep track of the loans. Banks monitored the loans through annual reports, interim reports, quarterly accounts and meetings to discuss problems arising. In addition, banks may also request management accounts, additional data and business plans. One of the CEOs puts it simply: “As long as the company services the loans and interests, banks do not interfere in company management”. Another CEO stresses: “Banks will only take an active role in company affairs when the company is in trouble, that is, when the gearing gets too high”. All the CEOs confirmed that banks do not appoint representative to the board. This is to avoid a conflict of interest. One of the CEOs interviewed clarified: “Banks need to take rationale decision and if bankers sit on the company boards, they may be reluctant to take the necessary action to protect its own interest”. A CEO of a large PLC adds that in certain cases, a banker may sit on the board as a condition for large loans but his role is limited to being a watchdog. Even though banks do not get involved in corporate governance processes, a CEO disclosed that they do look into general board processes before granting a loan. If corporate governance practices are found to be bad, banks would not lend. In addition, banks do rely on rating agencies and corporate governance practices have an impact on these ratings. The findings here suggest that banks cannot be relied upon to play a dominant role on issues of corporate governance in Malaysia.

Conclusion & Discussion

The interviews with the CEOs of PLCs revealed that the companies heeded the call of the government to improve corporate governance practices, even though they feel that the government is imposing burdensome rules. The CEOs felt frustrated that the KLSE rules are not fairly implemented giving the impression of an ‘uneven playing field’. The interviews done with CEOs confirmed the findings of the earlier econometric analysis of 120 companies based on data that is publicly available. Evidence obtained from the interviews confirmed that corporate governance practices are not crucial in improving firm performance. This finding is supported by other empirical studies (Abdullah, 2004; ADBI, 2006; Chuanrommanee & Swierczek, 2007). However, the CEOs do not deny that good corporate governance could save the company from gross mismanagement and its subsequent demise.

The findings in this study showed that there seems to be little evidence of a systemic governance structure and financial performance relationship in Malaysia, unlike evidence found in other countries such in USA and UK. This is collaborated by many other studies done in Malaysia (Yeboah-Duah, 1993; Mat-Not et al, 1999; Shamsher & Zulkarnain, 2001; Faizah, 2002), Singapore (Wong & Yek, 1991; Phan & Mak, 1998) and Thailand (Wiwattanakantang, 2000). The positive contribution of dominant CEOs in Malaysia may be partly due to the presence of concentrated ownership in family owned companies. However, such form of ownership structure has proven to be a stumbling block to reforms. For the long-term development of the capital market, concentrated ownership is not encouraged. The market for corporate control seems to be unable to exert any market discipline on family-owned banks (ADBI, 2006). Corporate governance structures such as independent board and audit committees do not seem to play any role in enhancing firm performance. Previous research has shown that there is no clear evidence of a substantive relationship between board composition and financial performance, irrespective of the type of performance indicators, the size of the firm or the manner in which board composition is measured (Dalton & Daily, 1999). A board could be completely independent and, at the same time fail in its expertise, counsel and resource-dependency roles. On the other hand, a board dominated by inside and affiliated directors could fall short in its ability to monitor and control (Daily & Dalton, 1994; 1997). Hence, reliance on the independence of board members or any one dimension of board roles and attributes will not ensure high levels of corporate financial performance, especially if it is at the expense of other director roles (Johnson *et al*., 1993; Dalton & Daily, 1999). It appears that the general adoption of specific governance structures may not be appropriate for all firms. The appointment of independent directors may be beneficial in certain circumstances. There may be difficulties involved in appointing a sufficient number of non-executive directors with the expertise to monitor a large diversified company. Simply adding to the number of non-executive directors may in fact create inertia problems as they struggle to understand the various parts of the business, request information and slow the decision making process. Equally, CEO duality may be beneficial if the CEO is a dynamic individual who has built a company up from the start. Therefore, business experience and entrepreneurship may be more important than board structures in determining performance.

The mechanisms for governance are complex, and some forms of governance can substitute for others. The behavior of a board is much more important than its composition (Ranft & O'Neill, 2001). One of the board's key roles is to develop a spirit of independent inquiry. Information can counter the opportunism and arrogance of the CEO, and lead to effective learning. Independent inquiry can take place only if the board develops its own information sources, and systematically analyses the firm's and the CEO's incentive base. Boards can always build the habit of using experts from inside and outside the firm to test the major premises of the CEO's strategy.

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