

**UMS**  
UNIVERSITI MALAYSIA SABAH

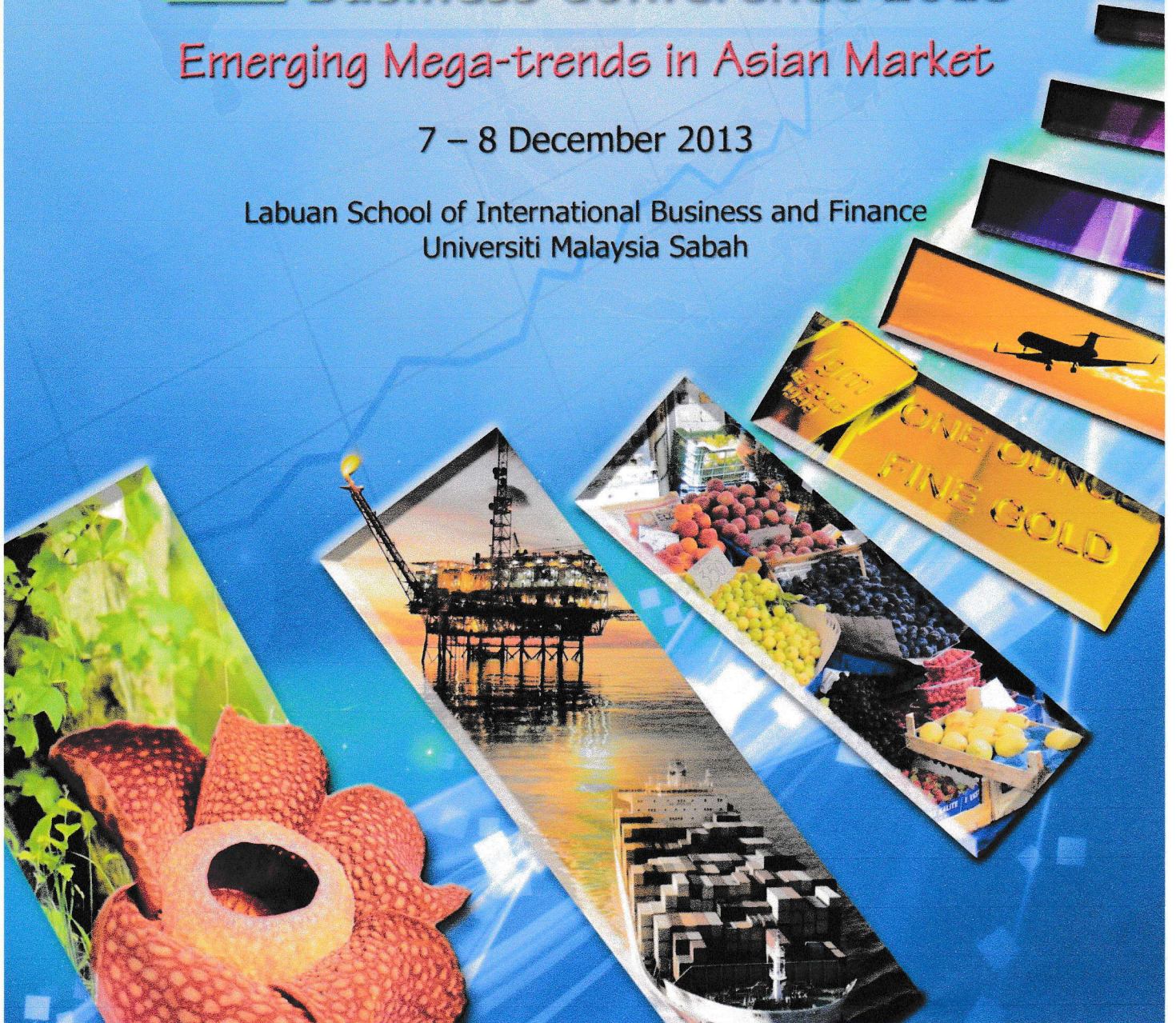
Proceedings of the

# 2<sup>nd</sup> Applied International Business Conference 2013

*Emerging Mega-trends in Asian Market*

7 – 8 December 2013

Labuan School of International Business and Finance  
Universiti Malaysia Sabah





## TABLE OF CONTENTS

Drivers for Green Practices among Manufacturers in Malaysia: Analysis between SMEs and LEs <i>Azmawani Abd Rahman, Khairul Anuar Rusli &amp; Jo Ann Ho</i> .....	11
Structural Relationships of Perceived Users Trust and Perceived Flow on Mobile Social Networking Service (SNS) Users' Loyalty <i>Norazah Mohd Suki &amp; Norbayah Mohd Suki</i> .....	17
Alternative Model for Micro Enterprises' Human Capital Development in Malaysia <i>Mohamad Asmy Bin Mohd Thas Thaker, Mustafa Omar Mohammed, Jarita Duasa &amp; Mohd Asri Abdullah</i> .....	28
Risk Decomposition: Systematic and Total Risks Variations <i>Meng Horng, Lee &amp; Meng Horng, Lee</i> .....	36
The Independent Directors of Malaysian Listed Firms and Their Busyness <i>Shamsul Nahar Abdullah</i> .....	55
Determinants Affecting Outward Foreign Direct Investment (OFDI) By Selected Malaysian MNCs <i>Nurul Azrin Ariffin</i> .....	67
A Brief Review on the Social and Economic Contribution: Evidence from International Financial Centre <i>Rosita Chong, Ho Chong Mun &amp; Ricky Chia Chee Jiun</i> .....	80
Vertical Intra-Industry Trade between ASEAN-5 and China in SITC 8 <i>Mui-Yin Chin, Chen-Chen Yong &amp; Siew-Yong Yew</i> .....	84
Financial Assessment of Government Incentives on Broiler Production in Peninsular Malaysia <i>Mohd Mansor Ismail, Amin Mahir Abdullah &amp; Tapsir Serin</i> .....	94
The Moderating Role of Informational Social Influence towards Online Group Buying Behaviour <i>Tracie Chin Sook Harn, Geoffrey Harvey Tanakinjal, Stephen Liason Sondoh Jr &amp; Hamid Rizal</i> .....	101
Do Malaysian CEOs Take More Debts Than Equities? <i>Qian Long Kweh, Wei Kiong Irene Ting &amp; Noor Azlinna Binti Azizan</i> .....	116
Determinants of Repayment Performance in Microfinance Programs in Malaysia <i>Norhaziah Binti Nawai &amp; Mohd Noor Bin Mohd Shariff</i> .....	127
Persepsi Pelajar IPTA di Terengganu Mengenai Gejala Sosial <i>Siti Sa'adiyah Binti Shafik, Mohd. Safri Bin Ali, Azyyati Binti Mohd Nazim &amp; Basri Bin Ibrahim</i> .....	137
Regulatory and Prudential Supervision Framework of Islamic Banking System in Nigeria: Lessons from Malaysia Experience <i>Muhibat Ayoni. Oladimeji, Muhammad Ridhwan Ab. Aziz &amp; Khairil Faizal Khairi</i> .....	147
The Impact of Islamic Dressing Styles On Sexual Harassment Prevention of Tertiary Institution Students in Nigeria <i>Muhibat Ayoni Oladimeji</i> .....	157
A comparative analysis of segment reporting in Hong Kong listed companies for pre- and post- IFRS No.8 periods <i>Yuanyuan Li, Jamal Roudaki &amp; Christopher Gan</i> .....	168

## THE INDEPENDENT DIRECTORS OF MALAYSIAN LISTED FIRMS AND THEIR BUSYNESS

**Shamsul Nahar Abdullah**  
International Islamic University Malaysia  
shamsulnahr@iiu.edu.my

### ABSTRACT

*The objective of this paper is to examine the extent to which the independent directors are independent of management and to what extent they are busy. From a sample of 200 non-finance Malaysian listed firms for the 2009 and 2010 financial years, it is observed that the almost 60% of the independent directors have professional backgrounds and another 20% are either serving or retired government servants. Hence, by virtue of their training, a majority of them are independent and objective. Findings also show that the largest shareholders of the sample firms are as follow: families (66%), government (4%); institutions (8%). On average, there are 1.5 family members or 21% of the board size. While the role of senior independent directors is very important in a concentrated ownership environment, only one quarter of the sample firms appoint senior independent directors. Out of 135 family owned firms, only one fifth appoint senior independent directors. As for board chairman, only 30% of sample firms and family owned firms appoint independent directors as the board chairman. In terms of independent directors' busyness, on average, each independent director holds one directorship in other listed firms. All independent directors seem to attend all board meetings. Hence, the independent directors appear to be not so busy and are able to discharge their duties.*

**Keywords:** board of directors, independent directors, nomination committee, busyness

### INTRODUCTION

In Malaysia, like any other East Asian countries, most of the listed firms are controlled by families. In fact, it has been found that two-thirds of East Asian companies are controlled by a single largest shareholder (Claessens, Djankov, and Lang, 2000). They also document that more than two-thirds of Malaysian listed companies are in family hands. Further, they show that 35% of the top 20 Malaysian listed companies are controlled by families and it goes to 84% for the smallest 50 companies. In an earlier survey, Claessens, Djankov, Fan and Lang (1999) found that one-fourth of Malaysian corporate sectors are controlled by 10 families. Being the largest shareholders, these families not only these families control the appointments of the board members, they also appoint the firm's CEO who is usually from their family. Since the board and the CEOs are involved in identifying the potential independent directors, the issue the "independence" of the independent directors always arises, especially in Malaysia where the culture of "network" or "guanxi" or "know who" plays a very important role.

The busyness of the independent directors is another issue in Malaysia as there is a limited pool of qualified individuals to serve on the boards. In addition to serving the board, independent directors also invariably sit on several board committees of the firm<sup>6</sup>. Because there are only two or three independent directors on the board, inevitably these independent directors will sit on the firm's NC, AC and perhaps on the firm's RC<sup>7</sup> as well. These two areas, i.e. the independence of the independent and the busyness of the independent directors, will determine the effectiveness of the independent directors. Hence, the

<sup>6</sup> MCGG 2000 recommends the establishment of the nominating committee (NC) and the remuneration committee (RC).

<sup>7</sup> MCGG recommends that the RC be composed wholly of non-executive directors.



objectives of this research are as follows: (1) to determine the independence of the independent directors, and (2) to determine the busyness of the independent directors by examining their memberships on the firm's board's sub-committees and on other listed firms' boards.

## Literature Review

### Corporate Governance in Malaysia

Corporate governance in Malaysian firms is largely shaped by the ownership patterns, which is closely-held in nature. Concentrated ownership is a result of family ownership of the Chinese. Their family businesses grew in size and eventually were listed<sup>8</sup>. Upon listing, the family continues to control the company with their significant shareholdings. By virtue of their shareholdings, they appoint the firm's top management and the directors who are among their family members. It is also a common feature in Malaysia for a family to own a number of listed companies and usually the ultimate owner is a private company, which controlled by the family members. This often leads to pyramidal ownership structure and to some extent, cross shareholdings also occur which could adversely affect the firm's corporate governance structure. The pyramidal shareholdings always result in the largest shareholders enhancing their control rights (LaPorta et al., 1999). Using their control rights, the ultimate shareholders appoint the board members who would act as the nominee directors and the top management of the firm whose interests are aligned with the controlling shareholders interest' and to some extent, the owners also actively participate in management (Khatri, Leruth and Piesse, 2003). Another notable consequence of the concentrated and pyramidal ownership pattern is interlocking directorships where the same directors serve on the board of the related firms, which complicate the firm's corporate governance mechanisms. In addition, having the same directors in a number of firms could lead to the risk of "group think".

Government ownership is another important ownership feature in Malaysia as a result of privatization of entities such as Tenaga Nasional, Telekom Malaysia and Petronas Dagangan, by the then Prime Minister Mahathir Mohamad in 1980's and 1990's. Upon the privatization, the Government still maintains its control over these privatized entities via Khazanah Nasional and Ministry of Finance Incorporated. In addition, the Government also formed Permodalan Nasional Berhad (PNB)<sup>9</sup> and Lembaga Tabung Haji<sup>10</sup> specifically to increase Bumiputera participation in the country's economy and savings. Hence, the ownership by Chinese families and the Government resulted in Malaysian listed firms being closely-held. In this environment, the protection of the minority shareholders is always an issue. As a result, the effectiveness of the board of directors especially on protecting the interest of the minority shareholders hinges upon the independence of the board of directors and the effectiveness of the independent directors<sup>11</sup>.

The Malaysian Government has taken many initiatives in order to address the issue of corporate governance to ensure the capital market is attractive to investors. The Companies Act (1965) stipulates on the minimum number of directors on a board and the fiduciary roles of the board members. The Bursa Malaysia, in 1987, via the Listing Requirements mandated the appointment of independent directors to the board of listed firms. Subsequently, in 1993, Bursa Malaysia mandated the establishment of the audit committees. In 1998, the High Level Finance Committee was established by the government to come with the recommendation on corporate governance in Malaysia. The output of the Committee was The Malaysian Code on Corporate Governance (MCCG) which was issued by the Securities Commission in 2000. To enhance shareholder activism and protect minority interests, the Minority

<sup>8</sup> The listing of small family firms was made possible when the Kuala Lumpur Stock Exchange created the Second Board for listing of smaller firms in 1988. In 2008, the two boards were merged, known as the Main Board, and a new board, namely the ACE is created for firms which are not qualified for listing on the Main Board.

<sup>9</sup> However, some of the funds that are managed by PNB are now opened for subscription by non Bumiputera.

<sup>10</sup> The principal objective of Lembaga Tabung Haji is to provide an avenue for the Muslims to deposit their money, who will then manage the deposits and provide returns to the depositors whose aim is to have enough savings to go to Mecca to perform haji.

<sup>11</sup> MCCG 2000 asserts that in the context of Malaysia, independence refers to independence from management and independence from a significant shareholder.



Shareholder Watchdog Group (MSWG)<sup>12</sup>, was established in 2000 after a recommendation by the Ministry of Finance in 1999. In 2001, the Bursa Malaysia issued Revamped Listing Requirements which introduced Chapter 15, which is known as Corporate Governance, which included a clause on requiring the board of a listed firm to “comply or explain” with regard to compliance with the MCCG in form of a statement in the firm’s annual report. The Chapter requires that a board have at least two of its directors or a third of its size being independent directors. It states that a director should not hold more than 10 directorships in listed firms.

In 2007, the MCCG was revised aiming at strengthening the board<sup>13</sup>. Among the changes in MCCG 2007 are on the roles of the Nominating Committee on the appointment of directors, annual assessment of the effectiveness of the board as a whole, disclosure on the number of board meetings in the annual reports, the requirement that the audit committee be composed wholly of non-executive directors and audit committee members be financially literate and at least one being a member of an accounting association or body; disclosure in the annual report the activities and the frequency of the audit committee meetings and establishment of an internal audit function which is answerable to the audit committee.

To strengthen further the external auditors’ fraternity, the government established the Audit Oversight Board (AOB) in 2010 which established under the purview of the SC. The main role of the AOB is to ensure that external auditors perform their duties as expected by the market and the general public. The AOB is given the authority to register all external auditors, examine their works and revoke their licenses if necessary.

In 2011, the Securities Commission issued Corporate Governance Blueprint 2011 which provides the action plans to raise the standards of corporate governance in Malaysia. The blueprint would be implemented over a period of five years via changes in the MCCG and Bursa Malaysia Listing Requirements. As a result, in 2012, MCCG 2012 was issued by the SC to replace the earlier MCCG 2000 and MCCG 2007. MCCG 2012 states that if the cumulative term of an independent director is more than nine years, the director would be re-designated as non-executive directors or if the firm wants to maintain the independence status of the director, the firm needs to explain in the annual report. Though the CG Blueprint 2011 appeared to favor the appointment of independent board chairman; the MCCG 2012 however settled with non-executive board chairman. However, MCCG 2012 requires that if the board chairman is not independent, the board must comprise a majority of independent directors. In the UK, at least half of the board members, excluding the board Chair, comprise independent directors (Financial Reporting Council 2010).

### **The Board of Directors**

The board of directors is at the peak of a firm’s internal corporate governance mechanisms and it acts on behalf of the firm’s shareholders. While the composition and the operation of the board is explained in the various rules, Acts or Codes, the members and the operation of the board are derived from two models: Anglo-Saxon or Germany-Japan model. The former stresses on the importance of the shareholders the firm in the firm’s corporate governance. The latter, on the other hand, stresses on the importance of the stakeholders in the firm’s corporate governance. The board of the Anglo-Saxon model comprises wholly directors that are appointed by the shareholders. On the contrary, the board of the Germany-Japan model consists of directors from various stakeholders. While the shareholder model has one board, the Germany-Japan model has two boards (i.e. the board of management and the board of supervisors). The CEO commonly sits on the board of the shareholder model; the Germany-Japan model, on the other hand, doesn’t allow an individual to sit on both boards at any one time. Therefore, compared to the board in the shareholder model, the board of supervisors in the Germany-Japan model is

<sup>12</sup> Members of the MSWG are the Employee Provident Fund (EPF), Lembaga Tabung Angkatan Tentera (LTAT), Lembaga Tabung Haji (TH), Pertubuhan Keselamatan Sosial (PERKESO), and Permodalan Nasional Berhad (PNB).

<sup>13</sup> The Code was revised to incorporate developments in corporate governance around the world, especially with the Sarbanes-Oxley Act in 2002 as a result of the collapse of Enron and WorldCom in the US. The Code was also revised following the financial scandals involving Transmile, which was dubbed as “mini” Enron.



able to reduce the risk of the conflict of interest between management and supervisors as control and ownership are clearly separated between the two boards.

The shareholder model seems to work well in an environment where ownership is dispersed; in a dispersed ownership environment, no single shareholder dominates the appointment of directors and thus the board as a whole. This is exactly the pattern of ownership in Western countries, such as the US, the UK, Canada and Australia. However, the scenario is markedly different even though Malaysia has adopted the shareholder model of corporate governance. Concentrated ownership is common in Malaysian firms, which resembles the ownership pattern in some European countries, such as Germany and Italy. Thus, the real corporate governance issue in Malaysia is on the alignment of the interest of the firm's largest shareholders and the minority shareholders. Ownership concentration and board composition are likely to be related to each other (Kim, Kitsabunnarat-Chatjuthamard and Nofsinger, 2007). Hence, this situation leads to the conflict between the controlling shareholders and the minority shareholders. While the controlling shareholders are well represented on the board (through nominee directors or their family members) and management, the minority shareholders rely on the independent directors to protect their interest.

Under a unitary board structure, the board plays dual roles: leadership and control and it is important the board plays those two roles effectively (Malaysian Code on Corporate Governance 2007). The independence of the independent directors is pivotal in ensuring the board carries out the controlling and monitoring function as argued by agency theory. The role of the board chairman in securing good governance is very crucial so as to ascertain the board as a whole is effective and individual or small group of individual should dominate the board's decision making (Securities Commission, 2000). The independent board chairman is seen as more able to infuse the culture healthy debate on issues that are brought the board and bring to the board a healthy scepticism and independence (Securities Commission, 2000). All decisions made at the board level should not be in the interest of achieving consensus which is always biased towards the views of the dominant voice at the meeting (Securities Commission, 2000).

In Malaysia, as in other East Asian countries, shares of the listed firms are closely-held and thus the issue of the conflict of interest between shareholders and the firm's managers does arise because the controlling shareholders dominate the board, who in turn dominates the appointment of the CEO. Due to the close relationship between the major shareholders, the decisions made by the board tend to benefit the major shareholders but may not be in the best interest of other shareholders, i.e. the minority shareholders and the stakeholders. This is where independent directors are needed to ensure that the other board members and the CEO always consider the interest of the minority shareholders while pursuing the interest of the major shareholders. Unless, the independent directors are independent and effective, they will not be able to carry out the controlling and monitoring function as expected. Hence, it is important that the right eco-system exists that enables the independent directors to perform their duties effectively. To this end, the Corporate Governance Blueprint 2011 (SC, 2011) emphasizes that the boards are expected by the stakeholders to play the role of stewards and guardians of the firm. It further says that the boards need "... to move away from their role as mere advisers to become active and responsible fiduciaries." (Securities Commission, 2011, p. 21). Essentially, the board should emphasize on the controlling role to ensure that the management pursues the interest of the firm's shareholders.

### **Nomination Committee**

Nominating committee is an important element of corporate governance mechanism because it identifies and nominates potential directors to the board. The independence of the committee is very crucial as so that it is not being influenced by management or the controlling shareholders of the firm. Hence, the nominees are individuals who are independent and are chosen based on merit. The US Congress (2002) requires that nominating committee be composed wholly of independent directors. The MCCG 2000 recommends that every company establish a nominating committee composed solely of non-executive directors, a majority of whom are independent directors. In MCCG 2007, the roles of the nominating committee are clarified. For instance, when identifying a candidate for directorship, the nominating committee needs to consider the candidate's skills, knowledge, expertise and experience,



professionalism and integrity. In the case of a candidate for independent directorship position, the candidate's ability to discharge the responsibilities/functions expected of an independent director needs to be assessed by the committee. In addition, annually, the committee needs to assess and to document properly the effectiveness of the board as a whole, the committees and each individual director including the independent directors and CEO. In MCCG 2012, the nominating committee is explicitly required to have measures to ensure that women candidates are also included in the firm's recruitment exercise for directorship posts. This additional requirement is the firm is moving towards gradual achievement of the Government's policy on 30% women on the boards.

All the above initiatives are intended to ensure that the nominating committee is independent and effective in carrying its prescribed roles. Hence, the role of the nominating committee is very important and in fact, Brown and Cayler (2006) reveal that there is a positive association between nominating committee independence and firm performance. However, Abdullah, Mohamad Yusof and Mohamad Nor (2010) fail to find an association between nominating committee independence and financial restatements in Malaysian firms.

### Methodology

A total of 200 non-finance firms were randomly selected from the list of firms that were listed in 2009, representing 27% of the population of listed firms (734). Stratified random sampling method was employed to determine the sample firms. The data were hand-collected from the sample firms' annual reports for financial year 2009 and 2010. For the purpose of sampling, finance firms were excluded because they are under different regulatory frameworks. The financial years for 2009 and 2010 were chosen because the MCCG code was revised in 2007 and 2009 was a year after the Global Financial Crisis in 2008. Hence, the financial years of 2009 and 2010 were appropriate to observe the impacts of the revised MCCG.

The variables are measured in the following manner. Board size is measured by the number of directors on the board on the balance sheet date. Board independence is measured by the proportion of independent directors on the board. Total assets are the sum of all assets on the balance sheet date. Family directors are defined as those who have family relationship among themselves or with the largest shareholders. Family owned firms are defined as firms whose shares are held by family members at 20 % or more. Government owned companies are companies whose shares are held by Government owned investment arm, i.e. Khazanah Nasional, Ministry of Finance Incorporated and the state governments. Institutional shareholdings are the sum of the shares owned by institutional shareholders, including EPF, PNB, LTAT, TH, PERKESO, SOCSO, banks and insurance companies. Institutional shareholders are defined as those organizations which pool large sums of money and invest those sums in shares, properties or any assets. The percentage of shares by the firm's largest shareholders is the cumulative shares both direct and indirect ownership by an individual/family/entity. Top thirty shareholdings are the cumulative shares owned by the firm's thirty largest shareholders. Shares owned by executive directors are the sum of direct and indirect ownership. ROA is measured by dividing profit after taxes by total assets. Gearing ratio is computed by dividing total liabilities by total assets.

### Results

A total of 400 firm years are available for analyses. Table 1 shows the population of listed firms, after excluding finance, close end funds and REITs, and the sample firms as at 31 December 2009. A total of 27% of the listed firms was included in the sample. Table 1 presents the descriptive statistics of the sample firms.



**Table 1** Descriptive statistics of firm's characteristics

Variable	Mean	Std. Dev.	Min.	Max.	Skew.
Board meetings	5.53	1.978	2	15	2.05
Board size	7.49	1.795	3	15	0.78
Total assets (in RM million)	3,830.2	30,784.3	31.9	567,051.3	16.16
Shares owned by the largest shareholders (%)	38.76	16.47	0	87.35	0.35
Institutional shareholdings (%)	11.84	20.36	0	96.23	2.46
Top 30 shareholders (%)	75.77	12.99	12.14	100	-1.17
Shares owned by executive directors (%)	28.48	21.83	0	72.89	0.038
Shares owned by non-executive (%)	5.06	11.65	0	79.60	3.385
Number of family directors	1.65	1.71	0	8	0.66
ROA (ratio)	0.035	0.078	-0.45	0.30	-1.08
Gearing (ratio)	0.407	0.194	0.00	0.91	0.18

Three observations are noted from the results in Table 1. First, ownership is closely-held where top 30 shareholders on average hold about 76% of a firm's shares. Executive directors, on the other hand, hold almost a third of a firm's shares. This indicates the significant voting power of a firm's executive directors. The combined shares owned by institutional shareholders stood at 12%, which is quite significant. However, individually, institutional investors generally hold insignificant amount of shares. Second, the presence of family directors is evident where, on average, there are almost two family directors on each board. Since on average there are eight directors on a board, family directors thus make up about a quarter of the board. Hence, family directors on the board and executive directors' ownership seem to be in tandem. Third, gearing is about 40 % of a firm's total assets; hence for every RM1 of asset, 40 cents are from liabilities. Therefore, working capital management is very important in order to meet the requirement to repay the liabilities when they are due. Table 2 presents the profiles of independent directors.

A total of 2,997 board seats were available in these 200 firms for the 2009 and 2010 financial years, of which, 1,320 were occupied by independent directors. Thus, about 44 % of the board seats are allocated to independent directors. It is noted that the independent directors attended almost all board meetings. On average, on each board, independent directors hold 3.3 directorships in other listed firms. Each independent director, on the other hand, on average, holds one other outside directorship in other listed firm. Hence, in terms of outside directorships, independent directors do not appear to over-commit themselves. In terms of age, a majority of the independent directors are near their retirement age, i.e. late 50's. With regard to tenure as independent directors, a majority of them have served on the existing boards for about seven year. As expected, independent directors do not hold a significant amount of shares. To understand further about the background of the independent directors, an analysis on the working experience was carried out and the results are shown in Table 3.



**Table 2** Descriptive statistics of the independent directors

Variable	Mean	Std. Dev.	Min.	Max.	Skew.
No. of independent directors	3.30	1.05	1	9	1.21
Independent directors on the board (%)	0.45	0.13	0.14	1	0.86
Attendance at board meetings of independent directors (%)	95.00	6.39	71.00	100	-1.28
No. of outside directorships of independent directors	3.91	3.99	0	24	1.74
Average outside directorships independent directors	1.18	1.13	0	6	1.28
Average age of independent directors (years)	58.73	6.47	36	76	-0.01
Average tenure of independent directors (years)	6.87	4.05	0.25	23.3	1.03
Shares owned by independent directors (%)	0.28	1.12	0	7.58	4.91

**Table 3** Working experience of independent directors

Background	Count	%	Mean	Std. Dev.	Min.	Max	Skewness
Politics	51	3.86	0.13	0.42	0	3	3.83
Entrepreneurship	231	17.50	0.58	0.75	0	3	1.05
Professional	749	56.74	1.87	1.03	0	7	0.51
Government	275	20.84	0.69	0.89	0	4	1.37
Others	14	1.06	0.04	0.44	0	1	0.12

As indicated in Table 3, the majority of the independent directors are professionals (e.g. accountants, lawyers, physicians, engineers and academics). On every board, there are about two professionals. Because there is a requirement by Bursa Malaysia for each listed firm to have at least one qualified accountant, as a result, on every board, there is at least one accountant on each board. About 20 % of the independent directors have experience in the government service. These directors are appointed because of their knowledge on the technical matters that involve the government authorities that the firms may need to deal with. Politicians make up less than 5% of the total independent directors. Thus, the presence of retired politicians is not really significant on the boards of Malaysian listed firms.



Table 4 presents the descriptive statistics major shareholders and the chairmen of the boards and other board committees.

**Table 4** Binary variables

Variable	Yes		No	
	Count	%	Count	%
CEO non-duality	315	78.8	85	21.2
Family owned firm	269	67.25	131	32.72
Government linked company	27	2.5	373	97.5
Independent Board Chair	127	31.75	273	68.25
Presence of Senior Independent director	95	23.8	305	76.3
Establishment of NC	367*	91.75	33	8.25
Establishment of RC	367*	91.75	33	8.25
Independence of the chairman of NC	302	82.28	65	17.72
Independence of the chairman of AC	392	89	8	11
Independence of the chairman of RC	302	82.28	65	17.72

It is found that for 40 companies, RC and NC are combined. The majority of the sample firms are family owned and only about 3% are Government Linked Companies (GLC). While almost 80% of sample firms separate the board chairman and CEO roles, only a third of the board chairmen of the sample firms are independent. Thus, a majority of the board chairmen are not independent and are related to the firm's largest shareholders. Therefore, the independence of the board as a whole from the largest shareholders might be impaired. One of the mechanisms a firm can adopt to ensure board independence in close-held firms is through the appointment of a senior independent director. However, the shown in Table 4, only 95 firms had senior independent directors on their boards as compared to 296 closely-held firms (269 family-owned firms and 27 GLCs). Thus, only 32% of closely-held firms have senior independent directors. In terms of the chairman of board committees, about 83% of the chairmen of nomination committees and remuneration committees are independent. While this is encouraging, it is vital that the chairman of these board committees be independent to ensure independence in the committee's decisions and judgments especially when it involves the nomination of new directors and the remuneration of the executive directors which should be performance-based. Table 5 shows details of the composition and activity of the audit, nomination and remuneration committees. The evidence will indicate the busy-ness of the independent directors.

As shown in Table 5, AC, NC and RC require six independent directors. Since on average there are three independent directors on a board, the evidence suggests that each independent director is a member of two committees. A total of eight annual meetings are convened by these three committees. As the average annual board meetings are eight, therefore, the total meetings in a year required for an independent director is about 14 (i.e. 5.5. board meetings and 8 committee meetings). It should be noted that on average, an independent director also holds another independent directorship in other listed firm. Thus, annually, each independent director needs to attend a total of 28 meetings, which translates into about two meetings a month. Table 6 shows details of the presence of senior independent directors.



**Table 5** Nomination Committee, Audit Committee and Remuneration Committee

Variable	N*	Mean	Std. Dev.	Min.	Max.	Skewness
Size of NC	367	3.17	0.74	1	8	3.08
Independent directors on NC	367	2.47	0.73	0	4	-0.53
Percentage of independent directors on NC	367	79%	0.22	0	1	-0.91
Frequency of NC meetings	181	1.46	1.06	0	7	2.49
Size of AC	400	3.15	0.44	2	5	2.10
Independent directors on AC	400	2.75	0.57	1	5	-0.09
Percentage of independent directors on AC	400	86%	0.16	0.33	1.00	-0.70
Frequency of AC meetings	399	4.96	1.37	1	15	2.64
Size of RC	367	3.26	0.86	1	8	2.16
Independent directors on RC	367	2.23	0.81	0	4	-0.17
Percentage of independent directors on RC	367	69%	0.23	0	1	-0.53
Frequency of RC meetings	210	1.72	1.59	1	9	2.60
Age of Senior Independent directors	95	63.05	7.09	42	77	-0.82

**Table 6** Cross-tabulation of the presence of Senior Independent Directors

Variable	Status	Presence of Senior Independent Director		
		Yes	No	Total
Family firm	Yes	58	211	269
	No	37	94	131
	Total	95	305	400
GLC firm	Yes	8	19	27
	No	87	286	373
	Total	95	305	400
CEO non duality	Yes (separated)	85	230	315
	No (combined)	10	75	85
	Total	95	305	400
Board Chair	Independent	30	97	127
	Non independent	65	208	273
	Total	95	305	400
NC chairman	Independent	74	228	302
	Non independent	19	46	65
	Total	93	274	367



The presence of senior independent directors in family-owned firms is about 21% and in GLCs is about 30%. Hence, even GLCs are not inclined towards appointing senior independent directors. Interesting observations are noted with regard to CEO duality and the independence of the chairman of NC. Out of 95 firms which appointed senior independent directors, 85 firms separated the roles of the CEO and board chairman. Similarly, 74 senior independent directors are found in firms which appointed independent chairman for their NCs. Therefore, the separation of the CEO and board chairman roles as well as independent NC chairman seems to be important in the decision to appoint senior independent directors.

## Discussion and Conclusion

The issue of independent directors is important they are seen as the ones who will protect the interest of all shareholders of a firm, especially the minority shareholders. While about 45 % of the board members are independent, it is very crucial that the board chairman is independent. The importance of independent board chairman lies on the fact that the board chairman leads the board and decides on the board agenda. An independent board chairman is needed in order to balance between ownership and control (Securities Commission, 2011). In fact, “An independent chairman will be in a position to marshal the board’s priorities more objectively and provide a voice for the independent directors.” (Securities Commission, 2011, p. 32).

The fact that a majority of the independent directors are professionals or retired professionals or top officials in the government service suggests that independent directors are appointed in order to seek their professional advice and expertise. Professional and (ex) top government servants make up about 76% of the independent directors. Perhaps also the independent directors serve as the window to the world for the board. Hence, the appointment of independent directors is consistent with resource dependency theory (Pfeffer 1973; Pfeffer and Salancik 1978). Resource dependency theory sees the board as an essential link between the firm and external resources, which is crucial for maximizing firm performance. The board is regarded as an important resource for a firm because it provides a link with the external environment (Hillman, Canella and Paetzold 2000; Palmer and Barber 2001). It has been argued that the ability of the board to link the firm with significant resources is one of the board’s key roles (Korac-Kakabadse, Korac-Kakabadse and Kouzmin 2001; Zahra and Pearce 1989).

Being professionals could suggest that independent directors are objective and independent in their mind and actions. Since professionals are bound by the Code of Ethics of their professional affiliations, even in the absence of a Code of Ethics in the firm, the independent directors will continue to act independently and objectively always strive to give the best as they are bound by the Code of Ethics of their profession. However, the question that remains is whether these independent directors can collectively ensure that the whole board acts in the interest of all shareholders and takes into account the interest of other stakeholders. As the number of independent directors on a board is about three out of about seven or eight directors, it is somewhat difficult for the independent directors to protect the interest of the other shareholders as well as the stakeholders if it involves an issue which favors the majority shareholders. Another important issue relating to independent directors is their tenure. An independent director who has served a board for too long may compromise his or her independence and objectivity. Therefore, in MCG 2012, there is a limit for the tenure of an independent director, which is 9 years. The result in this study revealed that the average tenure is about seven years. Hence, if the requirement on the tenure is to be enforced strictly, a majority of independent directors will be re-designated as non-independent directors in two years’ time.

In terms of the busy-ness, the independent directors in Malaysia do not appear too busy as each of them on average holds directorship in another listed firm. According to Ferris, Jaganathan and Pritchard (2003), busy directors are those who hold more than two outside directorships at the same time. Hence, given that each independent director holds two directorships at any particular time and the fact that they are either retired or near retirement, they should be able to give their commitment as a director. In fact, the average board meetings are found to be about five times a year. Further, their attendance to board meetings is almost perfect, which is at 95%.



As a conclusion, the backgrounds of independent directors, who are professionals and retired government servants, suggest that they are independent and objective. However, there is a high risk that the independent directors are not able to exercise their independent judgment as the board chairman found to be not necessarily independent. Second, the practice of appointing senior independent directors is not prevalent where only 95 firms had appointed senior independent directors. In light of the very high incidence of non-independent board chairmen and closely held firms, the presence of senior independent directors is very important as the independent directors need support from the senior independent directors to enable them to exercise their independent judgment. The recommendation in the MCCG 2012 on the need for a board to be composed in majority of independent directors if the board chairman is not independent could address the issue of board independence. In addition, almost all firms have established nominating committees even in the absence of Bursa Malaysia Listing Requirements. Thus, this is a positive development. Third, the independent directors do not appear to be busy as the majority hold only one directorship in other listed firm. Thus, they should be able to give their commitment to the firms that they appointed as director. This is supported by the fact that they attended almost all board meetings.

## References

- Abdullah, S.N. (2010). Profile of directors of Malaysian large plcs. *The Chartered Secretary Malaysia*, Mac/Apr Issue, 13-18
- Abdullah, S.N., Mohamad Yusof, N.Z. and Mohamad Nor, M.N. (2010). Financial restatements and corporate governance among Malaysian listed companies. *Managerial Auditing Journal*, 26(6), 526-554 .
- Brown, L.D. and Caylor, M.L. (2004). Corporate governance and firm valuation. *Journal of Accounting and Public Policy*, 25(4), 409-434.
- Claessens, S., Djankov, S., Fan, J.P.H. and Lang, L.H.P. (1999). Expropriation of Minority Shareholders: Evidence from East Asia. World Bank Working Paper 2088.
- Claessens, S., Djankov, S. and Lang, L.H.P. (2000). The separation of ownership and control in East Asian corporations. *Journal of Financial Economics*, 58, 81-112.
- Fama, E.F. and Jensen M.C. (1983). Separation of ownership and control. *Journal of Law and Economics*, 26 (2), 301-325.
- Ferris, S.P., Jaganathan, M., and Pritchard, A.C. (2003). Too busy to mind the business? Monitoring by directors with multiple board appointments. *Journal of Finance*, 58, 1087-1111.
- Financial Reporting Council (2010) The UK Corporate Governance Code. London: Financial Reporting Council.
- Hillman, A.J., Canella, A.A. Jr., and Paetzold, R.L. (2000). The resource dependence role of corporate directors: strategic adaptation of board composition in response to environmental change. *Journal of Management Studies*, 37, 235-255.
- Jensen, M.C. and Meckling, W.H. (1976). Theory of the firm: managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics*, 3(4), 305-360.
- Khatry, Y., Leruth, L. and Piesse, J. (2003). Corporate Performance and Governance: A Stochastic Frontier Approach to Measuring and Explaining Inefficiency in the Malaysia Corporate Sector. International Monetary Fund Working Paper, 1-26.
- Kim, K.A., Kitsabunnarat-Chatjuthamard, P. and Nofsinger, J.R. (2007). Large shareholders, board independence, and minority shareholder right: Evidence from Europe. *Journal of Corporate Finance*, Vol. 13, 859-880.
- Korac-Kakabadse, N., Kakabadse, A.K. and Kouzmin, A. (2001). Board governance and company performance: any correlations? *Corporate Governance*, 1(1), 24-30.
- LaPorta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R. (1999). Corporate ownership and control around the world. *Journal of Finance*, 54, 471-517.
- Palmer, D. and Barber, B.M. (2001). Challengers, elites, and owning families: a social class theory of corporate acquisitions in the 1960s. *Administrative Science Quarterly*, 46, 87-120.
- Pfeffer, J. (1973). Size, composition and function of hospital boards of directors: A study of organization environment linkage. *Administrative Science Quarterly*, 18, 349-363.



- Pfeffer, J. and Salancik, G.R. (1978). *The External Control of Organizations: A Resource Dependence Perspective*. Harper and Row, New York.
- Securities Commission (2000). *Malaysian Code on Corporate Governance*. Securities Commission, Kuala Lumpur.
- Securities Commission (2007). *Revised Malaysian Code on Corporate Governance*. Securities Commission, Kuala Lumpur: Securities Commission.
- Securities Commission (2011). *Corporate Governance Blueprint 2011*. Securities Commission.
- Securities Commission 2012. *Malaysian Code on Corporate Governance 2012*. Kuala Lumpur: Securities Commission: Kuala Lumpur.
- US Congress (2002). *The Sarbanes-Oxley Act of 2002*, 107<sup>th</sup> Congress of the United States of America. H.R. 3763, Government Printing Office, Washington, DC.
- Zahra, S.A. and Pearce, J.A. (1989). Board of directors and corporate financial performance: a review and integrative model. *Journal of Management*, 15(2), 291-334.