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'SAY ON PAY' IN EMERGING ECONOMIES – THE WAY FORWARD TO IMPROVE CORPORATE GOVERNANCE

Summary: *Current reform concerning directors' remuneration relies on improving legal rules and self-regulation to minimise expropriation of minority shareholders. These have prominently focussed on empowering shareholders. Nonetheless, it is unclear as to the extent these reform proposals are compatible within the concentrated shareholding structure. Some of the reforms taking place in developed countries are suited for dispersed shareholding structure and thus transplanting them to emerging economies with concentrated shareholders may be ineffective. Malaysia poses an interesting case study, especially to countries with similar ownership structure as the concentrated shareholding structure raises different agency problems. The issue of protection of minority shareholder rights and the prevention of abuse of the controlling power by paying excessive remuneration to the executives is therefore a subject of due consideration in Malaysia and countries with similar shareholding structures. This article recommends that Malaysia and other emerging countries look into encouraging limited shareholder empowerment in tandem with laws.*

Keywords: *corporate governance, minority shareholder protection, director's remuneration, say-on-pay, emerging economies*

I. INTRODUCTION

Current reform in some common law jurisdictions concerning directors' (including executives') remuneration relies on improving legal rules and self-regulation to minimise expropriation of minority shareholder through excessive remuneration.[1] These have

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1 See Simon Johnson *et al.*, "Tunnelling" in Klaus J, Hopt & Eddy Wymeersch, eds., *Capital Markets and Company Law* (Oxford University Press, 2003), 611–618, at 612; see also Simon Johnson, *et al.*, "Tunneling" (2000) 90 Am. Econ. Rev. 22.

prominently focussed on empowering shareholders. Nonetheless, it is unclear as to the extent these reform proposals are compatible within the concentrated shareholding structure. Some of the reforms taking place in developed countries are more suitable for dispersed shareholding structure and thus transplanting them to emerging economies with concentrated or controlling shareholders may be ineffective.

This research presents the position in an emerging economy; Malaysia poses an interesting case study, especially to countries with similar ownership structure as the concentrated shareholding structure raises different agency problems. The issue of concentrated ownership raise a key agency problem: the relationship between controlling shareholder and the minority shareholders. The issue of protection of minority shareholder rights and the prevention of abuse of the controlling power by paying excessive remuneration to the executives is therefore a subject of due consideration in Malaysia and countries with similar shareholding structures.

The discussion in this article is not only relevant for emerging economies or East Asian jurisdiction with concentrated shareholding structure but also in Europe as the incidence of concentrated shareholding has also been seen and is on the increase in this region.[2] The U.K. Financial Reporting Council (2011) has also acknowledged the changing shareholding structure depicted by the recent influx of companies with concentrated ownership structure into the London market. This article recommends that Malaysia and other emerging countries look into encouraging limited shareholder empowerment in tandem with laws. Laws developed in particular social and economic contexts can rarely be exported and hence Malaysia has to tailor one that suits it best.

The article is divided into six parts. After introducing the article in Part I, Parts II and III outline the law and economics theory underpinning shareholders' empowerment and relates this to the agency costs/problems in emerging economies. In this part the discussion is juxtaposed on the unique characteristic of the Malaysian public listed companies (PLCs). Part IV deliberates on directors' remuneration and the areas of concern for shareholders' empowerment in relation to directors' remuneration in emerging economics with concentrated shareholding structure using Malaysia as a point of reference. Part V provides suggestions as to corporate governance rules relating to the approval of executive compensation and the formulation of compensation policies and Part VI provides further recommendations to improve corporate governance in emerging economies.

II. CONTROLLING SHAREHOLDER STRUCTURE AND AGENCY PROBLEM

Theory suggests that where there is separation between ownership and control, there is misalignment of interests between the agent and the principal and thus where there is congruence in ownership and control, there is less agency costs because of the close monitoring

2 See G. Ferrarini & N. Moloney, "Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence and Reform Perspective" in Guido Ferrarini, *et al.*, eds., *Reforming Company and Takeover Law in Europe* (Oxford: Oxford University Press, 2004) at 275–276.

exercisable by the owners who are themselves managers.[3] However, where there is a correspondence of ownership and control, there is a possibility of expropriation by the controlling shareholders who will divert funds towards the generation of private benefits, by taking a disproportionate amount of the firm's current earnings.[4]

According to Kraakman *et al.*,[5] there are three generic agency problems that can arise in business firms. The first involves the conflict between the firm's owners and its hired managers where the owners are the principals and the managers are the agents. Here they state that:

> [T]he problem lies in assuring that the managers are responsive to the owner's interests rather than simply to the managers' own personal interests. The first category of agency problem is attributed to the dispersed shareholding structure [.][6]

The second agency problem involves the conflict between, on one side, owners who possess the majority or controlling interest in the firm and, on the other, the minority or non-controlling owners. This category of agency problem is attributed to the concentrated shareholding structure that is, where there is a controlling shareholder. Here they assert, "the non-controlling owners are the principals and the controlling owners are the agents, and the difficulty lies in assuring that the formers' rights and interests are not expropriated by the latter."[7]

The third agency problem involves the conflict between the firm itself (including, particularly, its owners) and the other parties with whom the firm contracts, such as creditors, employees and customers. Here they aver that "the difficulty lies in assuring that the firm, as agent, does not behave opportunistically toward these various other principals, such as by expropriating creditors, exploiting workers, or misleading consumers."[8]

Empirical research abounds indicating that there is expropriation of minority shareholders when there is block holders. Claessens *et al.*[9] presents a comprehensive study regarding the expropriation of shareholders in Asia including Malaysia. They use detailed ownership structure data to show expropriation in companies where block holders control significantly large proportion of shares compared to their ownership.[10] Scholars like Krishnamurthi *et al.*[11]

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3 *Ibid.* at 309.

4 Barclay, M., Holderness, C. G. & Pontiff, J.; "Private Benefits from Block Ownership and Discounts on Closed-end Funds" (1993) 33(3) Journal of Financial Economics 263–291.

5 R. Kraakman *et al.*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (New York: Oxford University Press, 2009) at 36.

6 *Ibid.*

7 *Ibid*.

8 *Ibid*.

9 Claessens, S. *et al.*, "Who Controls East Asian Corporations" in *Policy Research Working Paper 2054* (The World Bank, 1999).

10 Becht, M.& Mayer, C., "Corporate Control in Europe" (2002) 112(4) Revue d'Economie Politique 471–498, find that more than 25% of listed European companies have more than one large shareholder and Faccio, M., & Lang, L. H. P., "The Ultimate Ownership of Western European Corporations" (2002) 65 Journal of Financial Economics 365–395 using a sample of 3,300 Western European corporations, document the presence of a second large shareholder in 46% of the corporations with at least one controlling shareholder.

11 Krishnamurti, C., & Aleksandar, A., "Legal Environment, Firm-level Corporate Governance and Expropriation of Minority Shareholders in Asia" (2005) 38(1) Economic Change and Restructuring 85–111.

and Lemmon and Lins[12] have studied the joint impact of firm-level ownership structure and the legal environment for protection of shareholders using firm level data during the Asian Financial Crisis. They argue that firms with high control rights relative to their ownership have the ability to expropriate from the company.

Expropriation can take several forms.[13] There can be a transfer of resources from the firm to the controlling shareholders or persons associated with them through outright theft or fraud.[14] This can also occur through asset sales, contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees and expropriation of corporate opportunities.[15] The controlling shareholder can increase his financial entitlement and control rights through dilutive share issues, insider trading or enter into transactions that discriminate against minority shareholders.[16] An example of this is the lower dividend rates observed in Asia.[17] Even in the absence of outright theft or illegality, there can be distortion of incentives concerning economic decisions made by the controlling shareholder for the company.[18] In this type of controlling shareholding, expropriation of minority is usually done legally through the use of the voting power at general meeting or control over voting power through corporate groups and pyramid structures.

Different types of controlling shareholders have their own specific governance concerns. Controlling shareholders can arise through control by a family-group; a firm is said to be controlled by a family group if the controlling shareholder; that is, a person (rather than a state, corporation, management trust, or mutual fund) can garner enough shares to assure at least 20% of the voting rights and the highest percentage of voting rights in comparison to other shareholders is a family member.[19] Family companies have two structural characteristics that distinguish them substantively from other forms of ownership. A salient feature is that they tend to be controlled by relatively small parties of closely related individuals, whose control is typically dominant and uncontested.[20] It is very common to see some of these controlling individuals having a direct participation in the management of the company, often (though not always) as members of the top management team, which gives them considerable power over the companies, typically beyond their cash-flow rights.[21] Additional governance concern is the entrenchment of managers, often members of the family, who are put in place to ensure succession and control by the family unit. Attempts to remove them are often not successful

12 Lemmon, M., & Lins, K., “Ownership Structure, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis” (William Davidson Working Paper No. 393).

13 Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, “Law and Tunneling” (2011–2012) 37 J. Corp. L. 1–49.

14 *Supra* note 1.

15 *Ibid*.

16 *Supra* note 1.

17 Mara Faccio, Larry H. P. Lang & Leslie Young, “Dividends and Expropriation” (2001) 91(1) The American Economic Review 54.

18 Robert K. Fleck & F. Andrew Hanssen, “When Voice Fails: Potential Exit as a Constraint on Government Quality” (2013) 35 Int’l Rev. L. & Econ. 26–41.

19 La Pota, R., Lopez-de-Silanes, F. & Shleifer A, “Corporate Ownership around the World” (1999) 54(2) Journal of Finance 471–517; Chakrabarty, S., “The Influence of National Culture and Institutional Voids on Family Ownership of Large Firms: A Country Level Empirical Study” (2009) 15(1) Journal of International Management p. 32–45.

20 *Ibid*.

21 *Ibid*.

as it lacks the support of the majority shareholders who have familial relationship with the managers.

There is also the controlling shareholder who is the State or the government. Control is effected through the investment made in these companies by government statutory bodies (such as the state pension funds) or corporate entities (that may be private or public or listed on a stock exchange) where the government owns a controlling stake. Government control exists depending on the percentage or proportion of shares that is owned by the government. This can range from the percentage of shares required to establish control under the *Companies Act 1965* and has also been established by merely government presence as a shareholder. For example The Putrajaya Committee GLC Transformation Manual[22] defines controlling stake for the purpose of ascertaining whether the entity is a government-linked corporation is by referring to the government's ability (not just percentage ownership) to appoint board members, senior management, and/or make major decisions (*e.g.* contract awards, strategy, restructuring and financing, acquisitions and divestments, amongst others) where the State is the controlling shareholder. While these companies have preferential access to major government contracts[23] and in a way are ensured long-term businesses, there are several governance concerns.

Expropriation of minority shareholders could occur through transactions which are entered into, although not illegal or immoral, which are not commercially beneficial to the company and the minority shareholders due to the political goals inconsistent with shareholder wealth maximisation.[24] The company is insulated from traditional corporate governance mechanism that can be used to discipline errant behaviours such as the market for corporate control due to the political ties and connection. In addition to these, there could also be less accountability in these firms in particular and the market in general due to the conflict of the State as a regulator-investor.[25] There is also the procedural hurdle in suing the controlling shareholder who is the State, if minority shareholders decide to enforce their rights.[26]

There is also control by institutional shareholders who can be financial institutions, private pension funds (or superannuation funds), unit trust and mutual funds and life insurance companies. New institutional shareholders have also emerged in recent years: hedge funds, private-equity funds are just some examples of this evolving category of institutional shareholders. Where the controlling shareholder is made up of institutional shareholders, short-termism has been particularly identified as important setbacks that will affect implementation of any reform (EU Green Paper 2011).

22 See online at http://www.pcg.gov.my/faq.asp (5th May 2013 last accessed).

23 Gomez, E. T. & Jomo, K.S., *Malaysia's Political Economy, Politics, Patronage and Profits* (Cambridge: Cambridge University Press, 2002).

24 Marcel Kahan & Edward B. Rock, "When the Government Is the Controlling Shareholder" (2011) 89 Tex. L. Rev. 1293; William L. Megginson & Jeffry M. Netter, "From State to Market: A Survey of Empirical Studies on Privatization" (2001) 39 J. Econ. Lit. 321, 380 but contrast with Stephen Martin & David Parker, "Privatization and Economic Performance Throughout the UK Business Cycle" (1995) 16 Managerial & Decision Econ. 225, 235–236.

25 Mariana Pargendler, "State Ownership and Corporate Governance" (2012) 80 Fordham L. Rev. 2917.

26 *Ibid.*

III. CONTROLLING SHAREHOLDERS STRUCTURE IN MALAYSIA

Research on Malaysia indicates that there is a concentrated shareholding structure characterised by widespread presence of the family group and the State. Classens *et al.*[27] in their research in 1999 found that in Malaysia, the top 10 families control about 25% of the total market capitalisation. The majority of the public-listed companies in Malaysia are family-controlled, followed by significant state control.[28] This was supported by Thillainathan[29] who found that the shareholdings in PLCs in Malaysia are broadly concentrated. Thillainathan found that the dominant shareholder in Malaysian public-listed companies is the family, followed by the State, widely-held financial institutions and then widely-held corporations. Also, 85% of public-listed companies in Malaysia are owner managed where the post of Chief Executive Officer (CEO), Chairman or Vice-Chairman has been filled by a member of the controlling family or an employee drawn from the ranks of the controlling shareholder.[30] In Thillainathan's paper, an analysis of a sample of companies comprising over 50% of Bursa Malaysia's market capitalisation showed that the five largest shareholders in these companies owned 60.4% of the outstanding shares and more than half of the voting shares. Some 67.2% of shares were in family hands, 37.4% had only one dominant shareholder and 13.4% were state-controlled. More recent studies found that boards of family companies (more than 40 percent) are dominated by the incumbent family members.[31] Zulkafli *et al.*[32] (Figure 1) found that total shareholding of the five largest shareholders in Bursa Malaysia at December 1998 was 58.84%. A similar study in 2006 and reported in 2007 by On Kit Tam *et al.*[33] (Figure 1), showed that this has not changed as they found that the average concentration of the five largest shareholders in the top 150 Malaysian listed companies is 54.85%.

As an update to the literature above, the authors conducted a study in 2011 on the 50 composite index component companies listed on *Bursa Malaysia*. The selection was based on the market capitalisation of these companies as at 31 December 2010. This research utilised secondary data obtained from the respective companies' annual reports. The annual reports were chosen as the Listing Requirements of *Bursa Malaysia* requires all listed companies to disclose certain information in their annual reports, including share ownership. Keasey *et al.*[34] state that to ensure good corporate governance, a high level of disclosure in the annual report is essential.

27 *Supra* note 9.

28 Claessens, S. *et al.*, "Disentangling the Inventive and Entrenchment Effects of Large Shareholding" (2002) 57 Journal of Finance 2741–2771.

29 Thillainathan, R., "Corporate Governance and Restructuring in Malaysia – A Review of Markets, Mechanisms, Agents and The Legal Infrastructure" (1999), paper prepared for the joint World Bank/OECD Survey of Corporate Governance arrangements in a selected number of Asian countries.

30 *Ibid.*

31 Ameer, R., Fairuz, R. & Zakaria, H., "A New Perspective on Board Composition and Firm Performance in an Emerging Market" (2010) 10(5) Corporate Governance 647–661.

32 Zulkafli, A. H., Abdul Samad, M. F. & Ismail, I., *Corporate Governance In Malaysia* (Place of publication: Malaysian Institute of Corporate Governance, 2005), available at http://www.micg.net/research/ (last accessed April 2007).

33 Tam, On Kit & Tan, Monica Guo-Sze, "Ownership, Governance and Firm Performance in Malaysia" (2007) 15(2) Corporate Governance- An International Review 208–222.

34 Keasey, K., Thompson, S. & Wright, M., *Corporate Governance* (England Place of publication: Edward Elgar Pub., 1999).

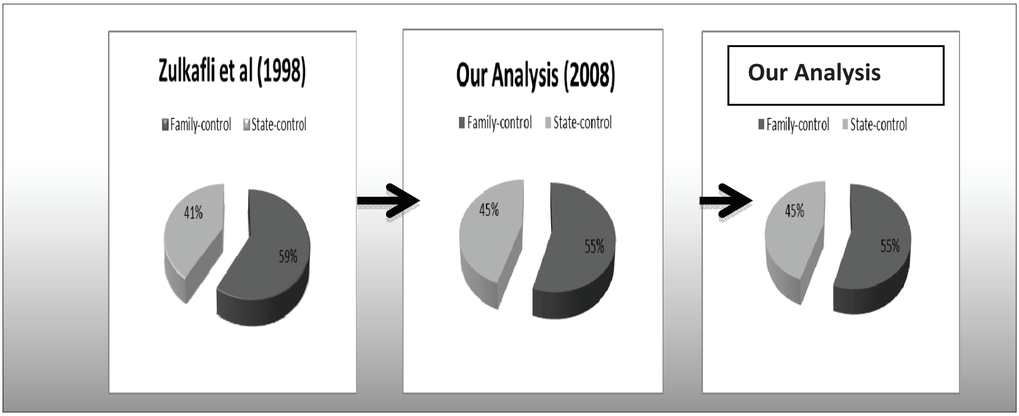
Our analysis in Figure 1 shows that the five largest shareholders in the top 50 Malaysian PLCs own an average of 55.09% of the total shares.[35] Among these 50 companies in 2010 and 2009, 47 (94%) and in 2008, 48 (96%) have concentrated shareholding with their five largest shareholders controlling 50% of the company.

Of these 50 companies surveyed in 2010, 38% had one dominant shareholder (more than 40% control). Eighty-five per cent of these companies were GLCs[36] and 15% were family owned companies in 2010, with approximately 50% of shares in family hands.[37] In 2009 and 2008 respectively, 32% and 36% had one dominant shareholder (more than 40% control). Of these companies, 75% and 61% of them were GLCs and 25% and 39% were family-owned companies respectively.

The research also shows that there are 26 GLCs with more than 5% shares in 2010, whereas there are 22 GLCs with more than 5% shares in 2009 and 25 GLCs with more than 5% shares in 2008. As for family owned companies, there are 15 with more than 5% shares in 2010, there are 20 with more than 5 shares in 2009 and there are 18 with more than 5% shares in 2008. Others including MNCs, there are 4 with more than 5% shares in 2010, 2009 and 2008.

The analysis shows that GLC have a higher concentration of share ownership than family owned companies. It further shows that there are more GLCs with dominant shareholders (more than 40%) than family-owned companies. The study also shows that as the shareholding gets more concentrated, there are more GLCs than family-owned companies.

Figure 1: Concentration of Family Control and State Control in Malaysian PLCs



Source: Abdul Hadi bin Zulkafli, M. Fazilah bt. Abdul Samad & Md Ishak Ismail, "Corporate Governance In Malaysia" (Malaysian Institute of Corporate Governance, 2005).

On Kit Tam & Monica Guo-Sze Tan, "Ownership, Governance and Firm Performance in Malaysia" (2007) Vol. 15 No. 2, Corporate Governance – An International Review 214.

35 Sourced from shareholdings analysis in annual reports 2006/2007 of respective companies from the Bursa Malaysia website, available at http://www.bursamalaysia.com/market/listed-companies/ list-of companies/main-market/ website (last accessed 20th November 2011).

36 EMIS database, available at http://site.securities.com (14th December 2011 last accessed).

37 Examples of family-owned PLCs in Malaysia, amongst others, are Genting Bhd, Berjaya Group Bhd, and YTL Berhad.

State control over PLCs in Malaysia is found in the growth of GLCs. In 1993, the Malaysian government set up Khazanah Nasional Berhad, which is the investment holding arm of the Government of Malaysia entrusted to hold and manage the commercial assets of the government and to undertake strategic investments. Khazanah was incorporated under the *Companies Act 1965* on 3 September 1993 as a PLC. The share capital of Khazanah is owned by the Minister of Finance, a body corporate incorporated pursuant to the *Minister of Finance (Incorporation) Act, 1957*. Khazanah is the trustee to Malaysia's commercial assets and its main objective is to promote economic growth and make strategic investments on behalf of the Government.

Khazanah has investments in over 50 companies, both in Malaysia and abroad with assets valued in excess of US$20 billion. Khazanah is also the key agency mandated to drive shareholder value creation, efficiency gains and enhance corporate governance in GLCs.[38] Some of the key listed companies in Khazanah's investment portfolio include Telekom Malaysia Berhad, Tenaga Nasional Berhad, CIMB Group, Proton Holdings Berhad, PLUS Expressway Berhad, Malaysia Airlines System Berhad, Malaysia Airport Berhad, UEM World Berhad, UEM Builders Berhad, PT Bank Lippo, and Time dotCom Berhad.

In the context of Malaysia, the government has a controlling stake in major decisions such as contract awards, strategy, restructuring and financing, and acquisition and investment.[39] Several empirical research have argued that while politically connected firms and Bumiputera-controlled firms are favoured and are able to obtain preferential treatment relating to access to capital and business opportunities,[40] they are generally perceived to be riskier, and have greater agency problems leading to increased monitoring costs.[41] Despite having access to government funds and preferential access to business opportunities, the economic performance was not impressive.[42] There has been allegation that the directors and managers of these government-linked companies were expected to follow directives from politicians who use the PLCs for personal, economic or political gain to the detriment of the company itself.[43] There are views that GLCs were often run by inefficient "Bumiputera" managers who did not have the expertise to manage the company. Despite the limited experience of those managing the companies, very little close monitoring was exercised by the government,

38 Khazanah Nasional, online: www.Khazanah.com.my (28th November 2011 last accessed).

39 Lau, Y. W., & Tong, C. Q., "Are Malaysian Government Linked Companies (GLCs) creating value?" (2008) 1(1) International Applied Economics and Management Letters 9–12.

40 Yoshihara, K., *The Rise of Ersatz Capitalism in South–East Asia* (Singapore: Oxford University Press, 1988).

41 Johnson, S. & Mitton, T., "Cronyism and capital controls: evidence from Malaysia" (2003) 67(2) Journal of Financial Economics 351–382; Yatim, P., Kent, P. & Clarkson, P., "Governance structures, ethnicity, and audit fees of Malaysian listed firms" (2006) 21(7) Managerial Auditing Journal 757–782; Gul, F. A., "Auditors' response to political connections and cronyism in Malaysia" (2006) 44(5) Journal of Accounting Research 931–963.

42 Authors *Bank Negara Report* (MalaysiaPlace of publication: Bank Negara Malaysia Publisher, 2009). It was below the RM19.3 billion achieved in 2007 when the global economic crises began. See Author, "title of article" *The Daily Express* (13 March 2009), available at *www.dailyexpress.com.my* (1st October 2013 last accessed): member of parliament, Lim Guan Eng, a qualified accountant, told parliament Khazanah's performance had not been encouraging despite the economic storm, saying its records showed that in 2008, Khazanah's portfolio fell RM 17.8 billion with overall Realisable Asset Value (RAV) deteriorating to RM 70.4 billion on December 31, 2008 from RM 88.2 billion on May 31 2008. He stated that t what was more worrying is the net worth, RAV less total liabilities, stood at RM 33.7 billion at 31 December 2008 against RM 53.1 billion at 31 May 2008. This amounts to a reduction of RM 19.4 billion or a drop of 36.5 per cent in just six months.

43 Gomez, E. T., & Jomo, K. S., *Malaysia's Political Economy, Politics, Patronage and Profits* (Cambridge: Cambridge University Press, 2002).

via Khazanah, who was the major shareholder and financier of these GLCs. This led to the emergence of government-controlled PLCs which lacked competitive, entrepreneurial ethos. They also remain immune from financial discipline and competitive market forces.[44]

Therefore, with family-owned and government-linked companies with these nagging governance issues, the question which is addressed in this article is whether the answer lies in effective shareholder participation, and the alignment of executive and board compensation policy with long-term interest of the company and its shareholders.

IV. REFORM ON DIRECTORS' REMUNERATION: THE CASE FOR MALAYSIA

A. SAY ON PAY

In most of the common law jurisdiction following the Anglo-Saxon model of governance, shareholders do not have a say on the remuneration of directors. Remuneration in terms of salary or fixed pay or directors' benefits in money or money's worth such as meeting allowances are decided by the board under the broad powers given to them to manage the company's affairs. Similarly in Malaysia, there is currently no regulation on voting by shareholders for directors' remuneration except in relation to public companies where the Listing Requirement of the stock exchange require shareholders to vote on any increase on remuneration and the award of stock option grants. However, there has been a move towards giving shareholders more voting rights. In 2006, the Malaysian Corporate Law Reform Programme recommended that directors' remuneration be made subject to shareholders' approval.[45]

Eary form of the say on pay rule requires shareholders to be given a non-binding voting on the remuneration report by passing an ordinary resolution. The United Kingdom[46] and Australia[47] are trailblazers with Canada[48] and the United States[49] only recently following suit. In the U. K. Executive Remuneration Discussion Paper 2011 the idea of making the shareholders' vote binding in nature was canvassed. However, separate consultations between March and

44 This is also highlighted in the following articles, Torii, T. Author, "The New Economic Policy and the United Malays National Organisation, With Special Reference to the Restructuring of the Malaysian Society." (2007). The Developing Economies, Volume 35, Issue 3, pages 209–239, " 209; Shamsul, A. B., "The Economic Dimension of Malay Nationalism – The Socio-Historical Roots of the New Economic Policy and Its Contemporary Implications" (1997) The Developing Economies: the journal of the Institute of Developing Economies, Tokyo, Japan; Carlton, Vic, Wiley-Blackwell, ISSN 0012-1533, ZDB-ID 4270290. – Vol. 35.1997, 3, p. 240–261; Heng, P. K., "The New Economic Policy and the Chinese Community in Peninsula Malaysia" (1997) 35(3) The Developing Economies 262.

45 A Consultative Document by the Companies Commission of Malaysia. *Clarifying and Reformulating the Directors' Role and Duties* (Malaysian, 2006).

46 See the U. K. Directors Remuneration Report Regulation 2002.

47 The *Corporations Act 2001* of Australia has included say-on-pay provisions since 2005.

48 "OSC staff notice 54–701 regulatory developments regarding shareholder democracy issues", available at http://www.osc.gov.on.ca/en/securitieslawrule2011011054-701reg-proposal.htm (3rd March 2012 last accessed).

49 The U. S. *Dodd-Frank Act* requires every public company in the United States to include in the proxy for its first shareholder meeting held on or after 21 January 2011 an advisory non-binding say-on-pay vote on executive compensation, as well as a separate vote to determine whether subsequent say-on-pay votes will be held annually, or at intervals of two or three years.

April 2012 which resulted in law reform proposals to review the *U.K. Companies Act 2006*,[50] did not proceed to make the vote binding. The change could have been influenced by views from the industry, in particular, by the United Kingdom Institute of Directors who was concerned about the legal implications of rewinding the remuneration contract and instead proposed an alternative in having the vote binding on the remuneration policy instead of on the remuneration itself.[51] The government did not pursue its earlier controversial suggestion that the binding vote be subject to *a higher majority*. In the Bill, the advisory vote is required for the approval of the director's remuneration report where the company is not required to take any action in response to this vote. The key change is the introduction of a binding vote on *future pay policy* requiring the support of a *majority of shareholders*. There was also a proposal to require an annual vote on remuneration policy but in the Bill, the binding vote would be held once every three years where the remuneration policy remains unchanged and any changes to the policy would require shareholders' approval by way of an ordinary resolution. The binding vote will also cover policy on exit payments where the company will not be able to pay more on exit than in accordance with the agreed policy, and will have to publish promptly a statement of payments a departing director has received.[52] These have been incorporated into the *Enterprise and Regulatory Reform Act 2013*.

In Australia, its initial non-binding vote was replaced by a "two strikes" rule,[53] which provide that listed companies that receive 25 percent or more votes saying "no" to the remuneration report in two consecutive years, must put a resolution to shareholders at the second meeting where the second "no" vote is made. This resolution, termed as a "spill resolution" requires the company to convene another meeting within 90 days ("a spill meeting"). The spill meeting must be convened if a resolution to do so is passed by 50 percent or more shareholders and each director will be held to have committed an offence if the spill vote was not called within the period. The purpose of the spill meeting is for the shareholders to re-elect its board members and at that spill meeting, the entire board, excluding the managing director is taken to have resigned. The shareholders are then free to re-elect them or any other person proposed by resolution for appointment to the board. At the Bill stage, the Bill received support from the legislators but the opposition did announce that they will require a *higher shareholder rejection* threshold, that is, more than 25 percent, before the spill vote may be called. However, the Bill was then passed with the 25 percent threshold.[54]

Following the onset of the 2008 financial crisis, the U. S. Congress enacted the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (*"Dodd-Frank Act"*) on July 21, 2010. It was said that enhanced shareholder "voice", as reflected and formalised in an advisory vote on the remuneration report, will alter those conditions in a way that is conducive to "arms-length"

50 Achieved through the introduction of the *Enterprise and Regulatory Reform Bill 2012*, Clause 71.

51 Institute of Directors, "Executive remuneration discussion paper", available at http://www.iod.com/mainwebsite/resources/document/executive–pay–discussion–paper.pdf (last accessed 29th November 2011).

52 This differs from earlier government proposals which would have given shareholders a binding vote on a case by case basis on any exit payment which exceeds the equivalent of one year's base salary.

53 The *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011* (Cth.).

54 *Ibid.*

bargaining, resulting in more efficient executive compensation contracting.[55] Section 951 of the *Dodd-Frank Act* included Say-on-Pay provisions that for the first time require public companies to hold a non-binding shareholder vote on executive compensation at least once every three years.[56] The first proxy season wherein shareholders were given the opportunity to voice their Say-on-Pay occurred in 2011.

After the 2011 proxy season, substantive legal battles on executive compensation and the Say-on-Pay provisions of *Dodd-Frank* have made their way to trial courts across the America. The shareholders have started to challenge the disclosures made in connection with Say-on-Pay votes in the proxy statements of certain public companies as not disclosing sufficient material information upon which shareholders can properly decide how to vote on executive compensation. Such lawsuits, filed in state courts, generally allege that the directors breached fiduciary duties, as shareholders have not been told of all material information which was reviewed and relied upon by the board of directors upon making their recommendations that shareholders approve executive pay.[57]

While shareholder's voting on directors remuneration has its fair share of supporters and an opponent, a concern addressed by this paper is the possibility that shareholders' approval for conflict of interest transaction including directors' remuneration may be distorted where there is concentrated shareholding. Expropriation by controlling shareholders has been facilitated by the legal position that enables majority shareholders to vote in their own interests. In Malaysia, minority shareholders are protected against expropriation by the oppression remedy in common law and statute and the legal rules relating to directors duties. Case law however shows that these are often construed restrictively to apply to private companies,[58] leaving the position of minority shareholders in public companies unclear. There are provisions in the *Companies Act 1965* and the Bursa Securities Listing Requirements that prohibits "related party transactions", that is, persons related or associated with directors from voting in certain types of transactions but these do not apply for remuneration of directors. In 2010, in the top 100 companies on the Malaysian Stock Exchange, Bursa Malaysia Securities Berhad, the company which paid out the highest director's remuneration was the family-owned company, Genting Berhad where the CEO is also a member of the remuneration committee. The amount paid was Malaysian Ringgit 111.5 million. While it is not suggested that this is an example of

55 Bebchuk, L., "Written Testimony Submitted Before the Committee on Financial Services United States House of Representatives Hearing on Empowering Shareholders on Executive Compensation" (2007) [further citation information?] Written Testimony Submitted by Professor Lucian A. Bebchuk William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Corporate Governance Program Harvard Law School. Before the Committee on Financial Services United States House of Representatives Hearing on Empowering Shareholders on Executive Compensation, March 8, 2007. http://www.law.harvard edu/faculty/ bebchuk/pdfs/2007HFSC.pdf. (last visited 12th June 2013).

56 Section 951 of the *Dodd-Frank Act* amends the *Securities Exchange Act* of 1934 by adding s. 14A, which requires companies to conduct a separate shareholder advisory vote to approve the compensation of executives. Section 952 of the *Act* requires compensation committees to be composed exclusively of independent directors. Relevant factors the exchanges must consider include the source of compensation of the director and whether a director is affiliated with an issuer or a subsidiary or an affiliate of a subsidiary. Section 953 says companies must disclose the relationship between executive compensation actually paid and the financial performance of the issuer.

57 Juan E. Monteverde, Emily C. Komlossy & Ross A. Appel, "Battling for Say-on-Pay Transparency" (2012), available at http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2013corporatecounselcl eseminar/71battlingforsayonpay.authcheckdam.pdf (18th June 2013last accessed).

58 *Prudential Assurance Co Ltd v. Newman Industries Ltd (No 2)* [1982] Ch 204, at 210.

expropriation but it does highlight the strong family influence on the outcome of remuneration decision.[59]

Out of the various reforms on "say on pay" in several jurisdictions, only Australia has noted the impact of concentrated shareholding on voting. The Australian provision also restricts voting by "key management personnel" and their "closely related parties" from voting on the remuneration report. "Key management personnel" is defined as persons having authority and responsibility for planning, directing and controlling the activities of a company, directly or indirectly, any director (executive or otherwise) of that company. "Closely related party" is defined as:

(a) a spouse or child of the member;

(b) a child of the member's spouse;

(c) a dependent of the member or of the members' spouse;

(d) anyone else who is one of the member's family and may be expected to influence the member, or be influenced by the member, in the members' dealings with the company;

(e) a company the member controls; or

(f) a person prescribed by the regulations for the purposes of this provision.

Thus, while say-on-pay reform proposal can be implemented in Malaysia, specific rules need to be put in place to minimise this potential distortion of the outcome due to the presence of the controlling shareholder.

In addition, there may be a need to define what remuneration is. Allowances and other forms of payment (except for share-based payments and fees) do not need shareholders' approval. In a study conducted by KPMG in Malaysia, it was found that of the remuneration paid to non-executive directors (NEDs), 53% was directors' fees, 44% non-fee remuneration and 3% benefits-in-kind. KPMG raised concerns that companies could be using that ambiguity to evade the approval requirement. The Malaysian Association of Company Directors relied on the non excessiveness of allowances payable as a basis for its view that there is no requirement for it to be subject to shareholders' approval. However, Bursa Malaysia has proffered the view that companies should have better engagement with shareholders by arranging for non-binding shareholders' vote on pay.[60] One company that had taken the initiative was a listed company, Sunrise Bhd. It had voluntarily presented its directors' remuneration report to shareholders for their approval although the vote is non-binding in nature. This was done in tandem with a resolution to obtain shareholders' approval for an increase in the remuneration to be paid to directors. The information was presented to inform the shareholders of comparative data of directors' salary in other companies in the same industry showing that the company's boards are *underpaid* in relation to performance compared to the other companies in the same industry. The resolution to increase directors' remuneration was approved based on the information presented by the company to its shareholders.

59 The CEO of Genting Berhad is Tan Sri Lim Kok Thay who is the son of the founder Tan Sri Lim Goh Tong. The CEO of Berjaya Group is the founder Tan Sri Vincent Tan who holds 41.23% of the shares. Both of them sit in the remuneration committee.

60 Aznita Ahmad Pharmy & Dorothy Teoh, "NEDs under the spotlight" (22th February 2010), available at http://www.theedgemalaysia.com/sports/161261-neds-under-the-spotlight.html (last accessed 7th December 2011).

B. REMUNERATION COMMITTEE

Under the current Malaysian regulatory framework, the Listing Requirement does not expressly require the establishment of a remuneration committee. There is no specific reference to the role of the remuneration committee under the Bursa Malaysia's Listing Requirement. Nonetheless, the remuneration committee has been a feature of the Malaysian Code on Corporate Governance (MCCG) since it was introduced in 2000.[61] The MCCG 2012 review retains the recommendation that listed companies establish a remuneration committee but states that companies without a remuneration committee should have board policies and procedures on matters that would otherwise be dealt with by the remuneration committee. The Malaysian Code on Corporate Governance contains recommendations in the form of Principles and Best practice that listed companies should comply with. While compliance is voluntary, listed companies are required by the Listing Requirements of Bursa Malaysia to state in their annual reports, the extent to which they have complied with the MCCG and explain the circumstances justifying departure from such best practices.[62] The MCCG 2007 recommended that details of the remuneration of individual directors must be disclosed in the annual report. The MCCG 2012 is silent on this but recommends that board remuneration policies and procedures should be disclosed in the annual report. It is interesting that the MCCG 2012 does not contain the wording which was found in the MCCG 2007 relating to the disclosure of remuneration packages of individual directors.

It is worth noting that the Malaysian Code on Corporate Governance 2012[63] already recommends that there must be a formal and transparent procedure for developing policy on executive remuneration. Data exists that by 2005, at least 90% of the companies in Malaysia have remuneration committees and that there has been an increase in the percentage of companies that establish remuneration committees from 20% in 2001 to 90% in 2005.[64]

Some other Asian jurisdictions are moving towards mandatory establishment of remuneration committees. The recent review of the Hong Kong Code on Corporate Governance resulted in changes to the Hong Kong Stock Exchange Listing Rules (effective 1 January 2012) and the Code on Corporate Governance (effective 1 April 2012). Listed companies in Hong Kong are required by the Listing Rules to establish a remuneration committee with a majority of independent non-executive directors, to be chaired by an independent non-executive director and with written terms of reference. Companies that fail to comply will have to explain why

61 The MCCG was published in 2000 and was recently revised in 2007. The 2007 MCCG was superseded by the MCCG 2012.

62 Paragraph 15.25 of the Listing Requirements. Note that this "comply or explain" approach was specifically mentioned in MCCG 2000 and 2007 but that statement is no longer put in the MCCG 2012 although in the MCCG 2012 , it is stated that: Listed companies are however required to report on their compliance with the MCCG 2012 in their annual reports.

63 This was also recommended by MCCG 2007.

64 The Price Waterhouse Coopers, (2005), "Board Remuneration & Practices in relation to Board Effectiveness: An Update" (2005) www.pwc.com/gx/en/corporate.../bestpractice2009jan2010.pdf. AN Mohd-Sulaiman & W J Wan Jusoh "Duty of Care, Skill and Diligence: A Survey on Non-executive Directors in Public Listed Companies in Malaysia." (2005) Vol 1 No 2 The Corporate Governance Law Review 305. A survey in 1998 found that most companies do not have a remuneration committee. However, a 2006 survey showed that at least 75% of listed companies have a remuneration committee. See "Malaysian survey on Public listed companies, Independent Non–executive directors and institutional groups" (2002) [Corporate Governance in Malaysia-An Investor Perspective 2006, The Institute of International Finance, Inc. http://www.iif.com/download.php? id=soTU1PxWTJc (last accessed 3rd July 2011).

and must rectify this non-compliance within three months.[65] This will mean that as part of the Listing Rules, the listed company must then establish a remuneration committee.

As discussed earlier, an important feature of the corporate landscape of public companies in Malaysia is the presence of family and state-owned business and owner managed by having a family or employee drawn from the ranks of the controlling shareholders as CEO, Chairman or Vice-Chairman. A perusal of the top 100 GLCs found that the highest remuneration was paid by the national telecommunication company, Telekom Berhad, which paid a total remuneration of Malaysian Ringgit 5.3 million. Telekom Berhad has only one independent director in their remuneration committee of four members. The national electricity board, Tenaga Nasional, another GLC paid the second highest directors remuneration of Malaysian Ringgit 3.75 million. Here the CEO sits in both the remuneration and nomination committee. There is some evidence in Malaysia of the remuneration process being used as a means of expropriation in family and state-owned firms due to the presence of a family member or employee drawn from the concentrated shareholders in the top position, making a non-family member or non-related person who is on the remuneration committee less independent and secure.[66] One improvement that can be made to the remuneration committee in Malaysia relates to its composition. While the MCCG 2012 (as well as the 2007 version) recommends that the composition of the remuneration committee be made up wholly or mainly of non-executive directors, there is no requirement that they be "independent non-executive directors".

There are some differences in how the remuneration committee operates. In general, the remuneration committee normally is authorised by the board to decide on remuneration issues. The U.K. Corporate Governance Code 2010 acknowledges that the remuneration committee's power is based on delegated authority from the board. The U. K. model states that the remuneration committee sets remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee also has "authority" over the level and structure of remuneration for senior management. The committee, which might include the chief executive, may also be delegated with authority to determine the remuneration of the non-executive directors. Where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association.

However, in the recent Hong Kong review, listed companies are given two models of the remuneration committee to be chosen and these models are given by the Hong Kong Code on Corporate Governance, the first is the current model of a remuneration committee which operates on the basis of delegated authority from the board to determine the specific remuneration packages of executive directors and senior management. This model gives the remuneration committee power to decide on remuneration. The second model is where the remuneration committee performs an advisory role to the board, with the board retaining the final authority for approval of executive directors' and senior management's remuneration. Under the second model, the remuneration committee will review the proposals made by the management on the remuneration of executive directors and senior management, and make rec-

65 Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules, (December 2010), available at http://www.hkex.com.hk/eng/index.htm (last access 2nd November 2011).

66 Syaiful Baharee Jaafar, Kieran James and Effiezal Aswadi Abdul Wahab, Remuneration Committee and Director Remuneration in Family-Owned Companies: (November 2012) 8(7) International Review of Business Research Papers 17–38.

ommendations to the board. The board will have the final authority to approve the recommendations made by the committee. The board may ask the remuneration committee to reconsider its recommendations. In addition, the review also highlighted that there is already a set of best practice guidelines for the board to disclose in its Corporate Governance Report the reasons it approves remuneration with which the remuneration committee disagrees. However, the review is recommending that this best practice guideline be upgraded to a code provision.[67]

The MCCG 2012 on the other hand does not have specific recommendation about the process for the remuneration committee other than recommending that "[t]he board should establish formal and transparent remuneration policies and procedures to attract and retain directors." This was in contrast to the MCCG 2007.[68]

The board of Malaysian listed companies need to focus more on the remuneration process so that the approval process is not rendered a mere formality particularly in view of the concentrated shareholding structure. There may be some costs in relation to increased shareholder engagement and the time companies spend on updating their policy towards directors' remuneration but these depend very much on the circumstances of the individual company and its shareholders and the behavioural response of both groups to the proposed changes. Better engagement between shareholders and companies at the point pay is being designed should help to reduce the number of occasions where payouts are out-of-sync with performance; which will subsequently reduce engagement costs. Better-designed pay has the potential to create more appropriate incentives for directors to promote the long-term value of companies, which will benefit shareholders. Further, this could also lead to more efficient allocation of resources (that is, more paid in dividends to shareholders instead of "excessive" reward to directors).

C. ENFORCEMENT: "COMPLY OR EXPLAIN" AND SHAREHOLDERS' ACTIVISM

While improvements to the remuneration committee's composition and role and responsibilities are beneficial, these changes are to be made in relation to the code on corporate governance. Enforcement of the Code on Corporate Governance relies on the "comply or explain" approach. However, the suitability of the "comply or explain" mechanism has been questioned in view of majority controlling shareholders.[69] The responsibility or enforcing the codes have been primarily the responsibility of shareholders but it is unlikely that the controlling shareholders will take steps to question non-compliance with the code particularly as the management are usually family members or the government. It is then left to minority shareholders to take action or the institutional shareholders which include government linked institutional shareholders.

67 *Supra* note 65.

68 See MCCG 2007: Part 2 Best practices in corporate governance–XXIII Use of Board Committees: Where the board appoints a committee, it should spell out the authority of the committee and, in particular, whether the committee has the authority to act on behalf of the board or just the authority to examine a particular issue and report back to the board with a recommendation.

69 2011 EU Green Paper on Corporate Governance in Financial Institution COM (2011) 164 [ec.europa.eu/internalmarket/company/docs/.../com2011–164en.pdf (last accessed on 5th November 2012).

Unlike more advanced jurisdictions, shareholders' litigation in Malaysia relating to directors' remuneration or shareholders' proposal that challenge or debate on the appropriateness of the remuneration are unheard of. There is minimal coverage or evidence of shareholders' activism on directors' compensation in Malaysia to date.[70] Company proposals on directors' compensation usually go unchallenged. There are some very rare instances of shareholders succeeding in relying on the oppression remedy in relation to directors' remuneration. In Australia, there have been documented incidents where shareholders expressed criticism of the remuneration of directors and in some cases attempt to block remuneration packages of directors. Some of the examples cited were companies like the National Australia Bank, David Jones Ltd and Coles Myer Ltd.[71] The say-on-pay on remuneration reports in Australia has also allowed shareholders to protest against under-performing directors; recently National Australia Bank's remuneration report received 17% no votes viewed as shareholders protest against long-term under-performance.[72] In Hong Kong, Lawton documented several examples of shareholders challenging the excessive remuneration paid to directors where the shareholders were able to recoup the excess payment.[73]

In Malaysia, resolutions relating to directors' remuneration are normally approved without much fanfare. The PWC 2005 survey on Bursa Malaysia Main Board Companies[74] showed that about 84 percent of companies surveyed obtain the approval for fixed fees at the end of the financial year as a lump sum while meeting fees are paid at the end of every meeting. It is very rare that shareholders do not approve directors' fees and company's proposals on remuneration usually go unchallenged. An example of this rare incident can be seen in Transmile Group Bhd, where the minority shareholders voted against paying the directors' fees for the previous financial year. Transmile was involved in accounting irregularities which resulted in the resignation of several directors, several of whom were close affiliates of the controlling shareholder and two of them have been charged with abetment in making a misleading statement in Transmile's quarterly financial report to the Securities Commission.[75]

Institutional shareholders in Malaysia also have traditionally been reluctant shareowners. But there have been some reports of institutional shareholders with government links becoming more participative although these were not in relation to directors' remuneration. In 2004, Employees Provident Funds (EPF), which was a minority shareholder in Golden Hope challenged the merger between two plantation companies as they were not happy with the pricing mechanism. At the meeting, EPF demanded for a poll but it was rejected by the chairman. An

70 See Siow Chen Meng, "Stock Options Bonanza", available at www.theedgedaily.com (last accessed 16 October 2006); Andrew Khoo, "My Say: a Move in the wrong direction" *The Edge* (25 May 2004).

71 See Hill, Jennifer G. & Yablon, Charles M., "Corporate Governance and Executive Remuneration: Rediscovering Managerial Positional Conflict" Vanderbilt Law and Economics Research Paper No. 3–2, available at http://ssrn.com/abstract=375240 (15th June 2013 last accessed) or DOI: 10.2139/ssrn.375240. Also available in (2002) 25 University of New South Wales L. J. 294.

72 John Durie, "Fury at NAB's underperformance is gathering steam" *The Australian* (14 December 2012) at p. 28, available at www.theasutralian.com.au/business (15th June 2013 last accessed).

73 Phillip Lawton, (1995) "Directors' Remuneration, Benefits and Extractions, an Analysis of their Uses, Abuses and Controls in the Corporate Governance Context of Hong Kong" Asian Journal of Comparative Law, 5, p. 430–458.

74 AN Mohd-Sulaiman & W J Wan Jusoh "Duty of Care, Skill and Diligence: A Survey on Non-executive Directors in Public Listed Companies in Malaysia." (2005) Vol 1 No 2 The Corporate Governance Law Review 305., *supra* note 64.

75 The company had initiated legal proceedings against the former directors but the case has been stayed pending the criminal action against the directors by securities commission, the malaysian capital market regulator.

EGM was convened by Golden Hope to consider a resolution to approve the voluntary general offer (VGO) by I&P to acquire Golden Hope's entire 62.2 per cent stake in Negara Properties. The EPF was later successful in obtaining a high court order to restrain I&P from proceeding with the proposal to buy Negara Properties from Golden Hope. This motivated Golden Hope to seek a declaration from the courts as to the validity of the chairman's decision. The case was then subsequently settled out of court. The merger subsequently did not take place.[76] In *Lembaga Tabung Angkatan Tentera v. Prime Utilities Berhad,*[77] the application for leave was brought by the plaintiff, Lembaga Tabung Angkatan Tentera (LTAT), that is, the Armed Forces Superannuation Fund,[78] who held 10% shares in Prime Utilities and had board representation. Prime Utilities had invested a substantial amount of money, that is, RM112 million with an investment company, Boston. However, the profit on the investment was not paid to the company nor did the company take diligent steps to recover. LTAT was given leave to sue the directors on behalf of the company. There are also more recent reports of involvement by shareholders activism platform such as the Minority Shareholders' Watchdog Group (MSWG)[79] in corporate governance.[80] In the failed merger exercise between Negara Properties and Golden Hope, EPF had written a letter of complaint to MSWG.[81] This research suggests that activism by MSWG could be more useful where conservative and collectivist cultural values prevail in society. Shareholders' activism via a proxy like MSWG where there is no direct confrontation by minority shareholders could be more fruitful where there is concern about backlash due to political ties and connections.[82]

76 Zaidi Isham Ismail, "GHope fails in bid to sell Negara Prop" *Business Times* (22 November 2005) (Malaysia). The proposed merger was between Negara Properties and Island & Peninsular. The failure could be due to failure to address minority shareholders' dissatisfaction (…) was reported that the valuation of Negara Properties was not acceptable to minority shareholders of GHPB who were concerned that they have not been fairly treated. This was also in consideration of the recommendations made by two independent advisers, Malaysian International Merchant Bankers Bhd (MIMB) to the shareholders of Negara Properties and Public Merchant Bank Bhd to the minority shareholders of GHPB respectively: see Dalila Abu Bakar, "MSWG wants GHope to reconsider VGO for Negara Properties" *Asia Africa Intelligence Wire* (18 March 2005), available at http://www.accessmylibrary.com/coms2/summary028619157782ITM (1st April 2012 last accessed). However, a merger between Island & Peninsular and Golden Hope Properties subsequent to this event obtained minority shareholders' approval. At the early stages of the merger, a discussion over t pricing was also raised. Massita Ahmad, "I&P receives shareholders' nod for proposed merger with GHope" *Asia Africa Intelligence Wire* (28 September 2004).

77 [2012] 2 AMCR 521.

78 This is a compulsory superannuation scheme for serving members (other than officers) in the Armed Forces who are required to contribute 10 per cent of their monthly salary to LTAT with the government as employer contributing 15 percent. Participation by officers is voluntary at a contribution of a minimum of RM 25 with a maximum of RM 200 monthly: see online at www.ltat.org.my (10th April 2012 last accessed).

79 MSWG was established as part of the governance reform agenda in Malaysia. It is a public company limited by guarantee funded by five founding organisations: Employee Provident Fund (EPF); Armed Forces Fund Board; National Equity Corporation; Social Security Organization and Pilgrimage Board. The objectives of MSWG activities are to develop and disseminate the educational aspects of corporate governance, to influence the decision–making process in public–listed companies as the leader of the minority shareholder interests, and to monitor breach and non-compliance of corporate governance practices by listed companies.

80 See Siti Sakinah Azizan, Rashid Ameer, "Shareholder activism in family-controlled firms in Malaysia" (2012) 27(8) Managerial Auditing Journal 774–794; Ameer, R. & Abdul Rahman, R., "The impact of minority shareholder watchdog group activism on the targeted firms' performance in Malaysia" (2009) 5(1) Asian Academy of Management Journal of Accounting and Finance 67–92.

81 Dalila Abu Bakar, "MSWG wants GHope to reconsider VGO for Negara Properties" *Asia Africa Intelligence Wire* (18 March 2005), available at http://www.accessmylibrary.com/coms2/summary0286-19157782ITM (2nd april 2012 last accessed).

82 Other past scandals include the Renong/UEM scandal. Here, the deal involving United Engineers (M) Bhd's (UEM) put-and-call option raised many unanswered questions. It can be traced to November 1997, when UEM purchased a 32.6% block in Renong Bhd, its parent company, from the market at RM 3.24 per share. The total cost came to about RM 2.34 billion. The deal sent the whole market fretting. From whom UEM purchased the shares is still not known. Hence, former Renong executive chairman Tan Sri Halim Saad, in an effort to appease UEM's minority shareholders and the regulator, entered into a put-and-call option, giving

Regulatory authorities have not generally been involved in enforcing compliance with the codes.[83] The E.U. report suggested that "[t]he authorities could make the monitoring results publicly available in order to highlight best practice and to push companies towards more complete transparency. Use of formal sanctions in the most serious cases of non-compliance could also be envisaged."[84] Malaysia's stock exchange, Bursa Malaysia Securities Berhad has taken enforcement action for non-compliance with the disclosure obligation by ensuring that information is not misleading and is sufficiently informative but without interfering with the substance of the company's corporate governance practice.[85] Despite Bursa Malaysia being one of the more active regulators in the region, Malaysia still suffers from low reputation in enforcement both at the international level[86] and by the domestic stakeholders.[87] This could be due to the small number of legal *enforcement actions* taken by the capital market regulator. The presence of government appointees and the governance concern that directors are appointed due to political ties and connections have also resulted in the belief amongst the stakeholders that there will be no disciplinary action for errant directors or for poor performance. This is not helped by recent settlements in high profile corporate scandals[88] as well as perceived conflict of interests in enforcing compliance with rules and regulations. One recent example is Sime Darby's acquisition of 30% shares in E&O. the capital market regulator, Securities Commission decided not to require Sime Darby to undertake a mandatory general offer as the shares were acquired

an undertaking to buy back the shares from UEM at RM 3.24, inclusive of the holding cost. The entire amount would come up to RM 3.2 billion on 14 February 2001, when the option was due. When the put option expired, there was however no settlement. In fact, Halim resigned from the Renong/UEM group in October 2001. Khazanah Nasional Bhd took UEM private in 2001 and later cancelled the option. UEM's chief executive then, Abdul Wahid Omar (now Datuk Seri), told reporters that the option was cancelled on 16 November 2001, because "UEM needs to retain control of Renong". So Halim got off without paying a cent of what was then valued at RM3.2 billion. See Tee Lin Say, "Famous past scandals", available at www.linsay@thestar.com.my (15th May 2012 last accessed).

83 Aiman Nariman Mohd Sulaiman,"Challenges of public and/or p rivate enforcement of the Corporate Governance Code" (2007) 6(1) Inter & Comparative Corporate Law Journal (ICCLJ) 17.

84 *Supra* note 69, at 19.

85 *Supra* note 83.

86 In the Credit Lyonnais Securities Asia (CLSA) produced corporate governance rankings for 495 firms across 25 emerging markets and 18 sectors. Further, the CSLA have done a survey on emerging markets and the results indicate that though Malaysia scored the highest amongst the 10 countries surveyed for the rules and regulations that it has implemented, the perception of its enforcement of the same has been very poor. See CLSA Emerging Markets, *CG Watch: Corporate Governance in Asia* (Hong Kong, Asian Corporate Governance AssociationPlace), 2002 and 2003. This annual survey which was initiated in the year 2000 is written by Amar Gill the Head of Hong Kong Research to examine the practice of corporate governance across 10 East Asian countries namely Hong Kong, India, Indonesia, Malaysia, the People's Republic of China, the Philippines, the Republic of Korea, Singapore, Taiwan and Thailand. The report "Fakin' It – Board Games in Asia" which was released on 5 May 2003 represents the first collaborative effort between CLSA and the Asian Corporate Governance Association (see www.acga-asia.org (5th June 2013 last accessed)). Also, ccommenting on the overall analysis of companies done under the CLSA Report 2012, CLSA Head of Asia Research, Amar Gill said: "Asian corporations fare worst on the independence of boards. The composition of the audit committee is a genuine test that most companies fail. Few have an independent chairman, and not many have a majority of independent directors. The potential for conflict of interest is a major issue." Singapore still remains on the top of the chart with good corporate governance followed by Hong Kong and China, Korea and Indonesia were named as countries where corporate governance is a major issue. See https://www.clsa.com/index.php (5 June 2013 last accessed).

87 See Janine Pascoe, "Corporate Law Reform and Some 'Rule of Law' Issues in Malaysia" (2008) 38 Hong Kong L. J. 769; see also OECD, "Corporate Governance in Malaysia: An Assessment" (Paper presented at the conference on Corporate Governance in Asia: A Comparative Perspective, organised by OECD, Korea Development Institute, the Government of Japan and World Bank), available at http://www.oecd.org/daf/corporateaffairs/corporategove rnanceprinc iples/ 1931420.pdf (5 June 2013 last accessed).

88 Bany Ariffin & Siong Hook, Law, "Family Control Business and Capital Market Development in Asean" (2008) 6 Icfai Journal of Financial Economics, 46–55.

from three different parties. There was a perception of conflict of interest in the decision.[89] The chairman of E&O who increased his shareholding in the company prior to the announcement was the husband of the then chairman of the Securities Commission (SC). The SC's decision prompted a minority shareholder to commence litigation against the SC for failing to compel the mandatory general offer. The case for judicial review of the regulator's decision is pending.

V. RECOMMENDATION ON DIRECTORS' REMUNERATION

In emerging economies, legal, market and cultural constraints are weak or absent. Thus corporate law and regulations is a much more central tool for motivating managers and large shareholders to create social value rather than simply transfer wealth to themselves from others. Nonetheless, any lessons from comparable jurisdictions need to look beyond the form of the rules of law and consider the institutional background. This article recommends that Malaysia and other emerging countries look into encouraging limited shareholder empowerment in tandem with laws. Laws developed in particular social and economic contexts can rarely be exported and hence Malaysia has to tailor one that suits it best.

The deficiencies in shareholder protection in Malaysia have been partially addressed through the use of legislation and more recently through codes of good governance.[90] The Malaysian Corporate Governance Blueprint 2011 issued by the Securities Commission has also briefly mentioned that research needs to be undertaken on directors' compensation in Malaysia.[91] The tone of the CG Blueprint on directors' remuneration suggest that the concern is about compensation levels that seem to be lagging behind regional practices and remuneration package of directors that may not be linked with performance. But more needs to be done. The high concentration of shareholdings in PLCs, the weaknesses of the legal institutions, the New Economic Policy which has led to political nepotism and cronyism, and the adolescent market all make it inappropriate to transplant company law from developed countries. The efficacy of the "comply or explain" enforcement approach to the Codes which inherently relies on shareholders activism limits its efficacy,[92] particularly where there is concentrated shareholding structure. Further, transplantation of the reform proposals to jurisdictions without ascertaining the suitability to a concentrated shareholding structure will undermine investor protection.

89 See Isabelle Francis, "Hot Stock: E&O rises after SC's legal setback" (3 October 2012), available at http://www.theedgemalaysia.com (15th August 2013 last accessed).

90 The Securities Commission of Malaysia's 5-year Corporate Governance (CG) Blueprint was launched in July 2011. It provides an action plan to elevate the standards of CG in Malaysia by strengthening self and market discipline and promote good governance. The MCCG (2012) would supersede MCCG 2007 effective from 31 December 2012.

91 There have been several research conducted on directors' remuneration in Malaysia. PriceWaterhouseCoopers has conducted a survey on board remuneration and practices in 2002. Another survey was for 2004: PriceWaterhouseCoopers, "Board Remuneration & Practices in Relation to Board Effectiveness: An Update", *supra* note 64. A 2009 research conducted by KPMG in Malaysia focused specifically on profiling non-executive directors' and their pay: KPMG and Audit Committee Institute, "2009 Non-executive Directors: Profile, Practices and Pay" (2009). In 2010, PriceWaterhouseCoopers published their study on financial directors' remuneration entitled "Performance Pays" comprising a finding of what is the current situation and also proposing a framework for setting remuneration in the financial sector.

92 *Supra* note 86.

This article establishes that shareholders in Malaysian PLCs encounter agency problems that are exacerbated by family-owned companies and government-linked companies. The policy objective in Malaysia is to address the impact of concentrated shareholding on any reform aimed at empowering shareholders by giving them more involvement in the decision-making process without ignoring the impact of controlling shareholding on exercise of voting power. In doing so, the authors recommend a two-prong process:

A compulsory Remuneration Committee for all public companies. The committee will be made up of at least three directors, with a majority of independent directors. The committee is authorised to recommend the company's compensation policy to the board of directors, and to approve the remuneration of the CEO and the directors. Therefore, the board of directors retains the duty to determine the compensation policy, but it must do so on the basis of the remuneration committee's recommendations.

Secondly, "say before pay" rules: The compensation policy recommended by the remuneration committee is to be approved by the board and then, before it takes effect, by the general meeting in a non-binding vote. If the majority of the minority shareholders do not approve the policy, the policy will be returned for further deliberation by the board, taking into account the rejection of the policy by the minority shareholders. In this instance, the authors also recommend a more active role be played by institutional shareholders and the Minority Shareholder Watchdog Group to ensure greater scrutiny of the policy. The board may ultimately approve the policy despite the minority's disapproval, if it finds that the policy is in the company's best interest. The remuneration policy must be approved at least every three years.[93]

VI. FURTHER RECOMMENDATION TO IMPROVE CORPORATE GOVERNANCE IN EMERGING ECONOMIES

Malaysia has come a long way in improving its' corporate governance regime. In July 2011, the Securities Commission Malaysia launched the Corporate Governance Blueprint 2011. With the theme Towards Excellence in Corporate Governance, the blueprint provides a 5 year action plan for raising corporate governance standards in Malaysia by strengthening self-discipline and market discipline and promoting greater internalization of the culture of good governance. One of the key outputs of the blueprint, the new Malaysian Code on Corporate Governance, was released in March 2012, superseding its predecessor, which was released in 2007. The code sets out broad principles and specific recommendations on structures and processes that companies should adopt in making good corporate governance an integral part of their business dealings and culture. Publicly listed companies should explain how they have complied with the recommendations in the code; and those that have not complied with the recommendations should explain why.[94]

93 Avi Licht, "Compensation guidelines, Executive Compensation" (2013), available at http://blogs.law.harvard.edu/ corp gov/tag/avi-licht/ (2nd August 2013 last accessed).

94 ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2012–2013.
Joint Initiative of the ASEAN Capital Markets Forum and the Asian Development Bank. http://www.adb.org/publications/asean-corporate-governance-scorecard-country-reports-and-assessments-2012-2013.

Some of the initiatives may be used as a roadmap for other emerging economies. Some of the initiatives taken by Malaysia include:

- Introducing quorum for board meetings to include a mix of executive, non-executive and independent board members
- Establish term limits for non-executive directors
- Tighten disclosure and monitoring of related-party and off-balance sheet transactions

Further, in Malaysia, enforcement functions at the regulatory level have been strengthened. It has also made the complaint, investigation and fines/penalty process more transparent and public. This will help dispel current perceptions that there are no repercussions to non-compliance with rules and regulations.

However, it would be good for Malaysia and other emerging economies to take the following specific actions:

- Allow cumulative voting in director elections.
- A majority vote by all shareholders to dilute voting or ownership rights.
- Introduce mechanism through which minority shareholders can formally present a view to the board if they own some predefined minimum threshold of outstanding shares.
- Modify procedures to allow for a more liberal use of class action lawsuits
- Mandate through law the approval by shareholders of anti-takeover devices
- Encourage shareholder activism by requiring disclosure of voting records by institutional investors.

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"ODLUKA O PLAĆAMA" U GOSPODARSTVIMA UBRZANOG RAZVOJA – KAKO UNAPRIJEDITI UPRAVLJANJE TVRTKOM

Sažetak

Aktualna reforma koja se odnosi na direktorske naknade oslanja se na izmjene pravnih propisa i samoregulatornih akata kako bi se izvlaštenje manjinskih vlasnika svelo na minimum. Ti su propisi poglavito usmjereni na povećanje ovlasti vlasnika. Međutim, nije posve jasno do koje su mjere prijedlozi ovih promjena prikladni za koncentriranu strukturu vlasništva. Neke od reformi koje se provode u razvijenim zemljama prikladne su za disperzivnu strukturu vlasništva i stoga bi njihova neselektivna primjena u gospodarstvima ubrzanog razvoja mogla biti neučinkovita. Malezija predstavlja zanimljiv slučaj, osobito za zemlje sa sličnom vlasničkom strukturom, budući da koncentrirana struktura vlasništva izaziva mnogo problema agencijama. Pitanje zaštite prava manjinskih vlasnika te sprječavanje zloporabe nadzorne ovlasti preko plaćanja visokih novčanih naknada izvršnim upraviteljima predmet je kojemu treba posvetiti dužnu pozornost u Maleziji i zemljama sa sličnom vlasničkom strukturom. Ovim se člankom sugerira da Malezija i druge zemlje ubrzanog razvoja trebaju razmotriti osnaživanje ograničenog proširenja ovlasti vlasnika u skladu sa zakonom.

Ključne riječi: *upravljanje tvrtkom, zaštita manjinskih vlasnika, nagrađivanje direktora, odluka o plaći, gospodarstva ubrzanog razvoja*