

CSR-BASED CORPORATE GOVERNANCE: A MALAYSIAN STUDY

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Abstract

The current study focuses on corporate social responsibility-based corporate governance (CSR-based CG) reporting that is purely based on information divulged in the annual reports of the country's top 100 public listed companies (PLCs) by market capitalization. It highlights the companies with the highest scores vis-à-vis reporting on their CSR-based corporate governance practices and the areas in which they excel in. The annual reports of these companies have either been obtained directly from the organizations concerned or from their respective websites via links from Bursa Malaysia. A CSR-based Corporate Governance Score Checklist is used in ensuring consistency in analysing the annual reports. A 5-point Likert Scale is used to measure the CSR-based CG attributes, a "5-point" score denotes the maximum level of compliance and acceptance of the gauged attributes for CSR-based CG reporting whilst a "1-point" score represents low or no compliance. The results of the study reveals that there is much room for improvement vis-à-vis Malaysian companies' reporting of their CSR-based CG practices, as the average reporting score of these sample firms only came up to 55.1% for the period 2006 and this figure has slightly improved relative to the average score of 52.2% obtained in 2002. Furthermore, CG reporting has been found lacking mainly in areas such as Strategic Planning and Performance Management, Risk Management and Internal Control, Financial Matters, Human Capital, and Intellectual Capital. As such, improvement may involve the implementation of corporate-wide internal programmes in most of these areas.

Keywords: Corporate social responsibility, corporate governance reporting, corporate social responsibility-based corporate governance framework

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Introduction

In its effort to enhance the quality of corporate reporting in Malaysia, the Bursa Malaysia Securities Berhad (Malaysian Stock Exchange Agency) has proposed several disclosure frameworks under its listing requirements. For example, Chapter Sixteen of the Listing Requirements of Bursa Malaysia Securities Berhad sets out the requirements that must be complied with by a listed company and its directors with regard to corporate governance. Specifically, this paper highlights on the need for listed companies to comply to the listing requirements in reporting information related to Directors (e.g. composition, rights, vacation & removal, compensation and directors training), Audit Committee (e.g. composition, functions, rights and review process), Auditors (e.g. appointment & removal of external auditors, review of statements and right to request for meeting) and Corporate Governance Disclosure. The later should be further elaborated based on the requirements proposed by the Malaysian Code on Corporate Governance.

The Bursa Malaysia Corporate Social Responsibility Framework (CSR Framework) which

was launched in 2006 requires PLCs to disclose their CSR activities. The framework looks at 4 main focal areas: the Environment, the Workplace, the Community and the marketplace.

The Silver Book – one of the 10 initiatives identified by the Putrajaya Committee on Government Linked Companies (GLC) High Performance launched in 2005 - also provides guidelines on how GLC can contribute to a society in a responsible manner. A contribution to society is defined as an *activity undertaken by a business where the primary objective is to benefit the society in which it operates, or to benefit groups of individuals or communities within that society*. The Silver Book identifies seven core areas namely Human Rights, Employee Welfare, Customer Service, Supplier partnership, Environment Protection, Community Involvement and Ethical Business Behaviour. Nevertheless the book is not meant to be prescriptive. All GLCs are therefore encouraged to use it as a guideline, to complement the business judgment of the companies' BOD, CEO and senior management.

For Malaysian companies, particularly the PLCs, the practice and the reporting of corporate governance and CSR should not be done in isolation. The

MCCG's four governance dimensions (Board of Directors, Directors Remuneration, Shareholders and Accountability & Audit) and CSR's seven core attributes could be effectively integrated in what could be called CSR-Based Corporate Governance.

Based on this premise, the main focus of this paper is to review a study that examined the level of CSR-based corporate governance reporting of top 100 Malaysian PLCs (The consortium which had conducted the survey comprises representatives from the Accounting Research Institute, Universiti Teknologi MARA (UiTM), the Malaysian Institute of Corporate Governance (MICG) and Biz Aid Technologies Sdn Berhad, a CG solution company). It highlights the companies with the highest scores vis-à-vis reporting on their CSR-based corporate governance practices and the areas in which they excel in. Previous studies in Malaysia have examined either the level of corporate social disclosure (for example, Thompson and Zakaria, 2004, Mohamed Zain and Janggu, 2006 and Haron et al., 2006) or the level of corporate governance disclosure (for example, Che Haat, Abdul Rahman and Mahenthiran, 2008), however this is the first study in Malaysia that focuses on CSR from the perspective of corporate governance.

Basically, a study on CSR-based corporate governance promotes the notion that corporations have a duty of care to **ALL** of their stakeholders in all aspects of their business operations. Stakeholders here can include but are not limited to employees, suppliers, customers, community, organizations, subsidiaries, affiliates, joint venture partners, local neighborhoods, investors and shareholders. CSR-based governance principles require that businesses account for and measure the actual or potential economic, social and environmental impacts of their decisions. In this respect, an assessment instrument known as the *CSR-based Corporate Governance Reporting Scores* framework was developed to incorporate both the reporting requirements specified by the Malaysian Code of Corporate Governance (hereinafter referred to as the Code) and the CSR Framework. A two-year study on CSR-Based CG reporting among Malaysian companies was carried covering the financial periods 2002 and 2006. The annual reports of these companies have either been obtained directly from the organizations concerned or from their respective websites via links from Bursa Malaysia. The year 2002 was chosen as the base year since conformance to the Malaysian Code on Corporate Governance ("MCCG") or "the Code" had only been made a listing requirement on 1st January 2001. The year 2006 is chosen as the comparison year to examine if the level of CSR-based corporate governance disclosure has changed since 2002.

Literature Review

Corporate governance (CG) is the process and structure used to direct and manage the business affairs of the company towards enhancing business

prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders (Keasey et al., 1997). Corporate Social Responsibility (CSR) is one of the CG's components that have received numerous attentions as it is proposed by the Listing Requirement of Bursa Malaysia. There are few rationales behind the imposition of the CSR activities.

Some activities of irresponsible firms have led to various social and environment problems that had caused other parties to bear the risks and face the negligence impact. Examples of these problems: polluted river from spilled oil affects the marine habitats, and people nearby; harmful chemical toys that affect the children's health; illegal logging extraction affects the population of wild animals. Enforcement of CSR would educate and make companies more responsible in their actions.

CSR is becoming increasingly important to justify business practices to society in general and to stakeholders specifically. CSR is defined as a business organization's configuration of principles of social responsiveness, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the company's societal relationships" (Wood 1991).

The publicly owned firms disclosed more social and environmental information as they are politically supported and are large, they must however make more disclosure due to reasons of accountability and visibility, as outlined in the legitimacy theory (Cormier and Irene, 2001).

In examining the possible dimension of CSR, Thomson and Zakaria (2004) found that 257 largest Malaysian public listed companies in the year 2000 make most disclosure on employees and human resources (40%), followed by products and consumers (24%), community involvement (22%) and environment (16%). A study by Mohamed Zain and Janggu (2006) that examined social and environmental disclosures of 37 construction companies over the period 1998 to 2002 also revealed that human resource is the most popular theme of disclosure, followed by community involvement, environment and product. Using a sample of 457 respondents, Dusuki and Tengku Mohd Yusof (2008) provide evidence that Malaysian stakeholders ranked the four dimensions of CSR as economic, ethical, legal and philanthropic accordingly.

The current study focuses on 10 CSR-based Corporate Governance attributes, as follows:-

1. Strategic Planning and Performance Management

Under this attribute, the directors are responsible and expected to actively participate in the decision making process. Any decisions made would affect positively or negatively to the companies' strategic

planning and performance management. The strategic decision making process tends to address the long term goals. The logic for setting aside the strategic decisions is based on market changes and then short term plans are generated to accomplish immediate goals. When the immediate goals are not integrated into the strategic decision making process the company operates in an “ad-hoc” manner and the board loses control of the company. It is at this point that the directors need to review the strategic decision making process to insure that the short term and immediate goals are congruent with the decisions that have been made for the company’s long term success (Scherrer, 2003).

2. Board, Committee and Management

The board should comprise representatives of all parties that are critical to a company’s success. The board is seen as one of a number of instruments that may facilitate access to resources critical to company success. There are four primary types of broadly defined resources provided by boards of director as highlighted by Abor and Biekpe (2002):

- Advice, counsel, and know-how;
- Legitimacy and reputation;
- Channels for communicating information between external organizations and the firm; and
- Preferential access to commitments or support from important actors outside the firm (Pfeffer and Salancik, 1978).

This resource role is played by the board of directors mainly through their social and professional networks (Johannisson and Huse, 2000), and through interlocking directorates (Lang and Lockhart, 1990).

3. Risk Management & Internal Control

The corporate governance framework was designed to manage risk through, inter alia, the accountability mechanisms of financial reporting, audit and internal control (Spira and Page, 2002). In the US, the Treadway report was produced in 1992, specifically addressing the role of internal controls in securing improving corporate governance (COSO, 1992). It contained an analysis of features of internal control and a framework for its establishment and evaluation (Spira and Page, 2002). The report defined internal control as: A process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:-

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

Internal control is one of the most important mechanisms of delivering accountability and enables organisations to monitor and control their operations (Jones, 2008). If this internal control is not properly being monitored and implemented, it could contribute to risk management. In risk management, risk identification is the basic stage that needs to be determined. The importance of risk identification is determined by the necessity of knowing risks facing the organization. The following points are highlighted by Tchankova (2002):-

- Risk identification is a process that reveals and determines the possible risks facing the resources of the organization
- Risk identification is carried out by the investigation of organizational activities in all directions and at all managerial levels. Internal and external environmental changes require risk identification to be held continuously for revealing new risks.
- Implementation of a frame approach to risk identification: sources of risk-hazard factors, perils-resources exposed to risk, is a modern way for systematic risk identification. It allows us to reveal the relationship between the cause and consequence of the event
- Proposed classification of risk sources – physical, social, political, operational, economic, legal and cognitive environment – allows us to cover all types of risk facing the organization
- Introduced groupings of the resources exposed to risk – physical, human and financial resources – are based on a practical consideration of the risk situations in the organizations.

4. Ownership Structure and Concentration

Imam and Malik (2007) found that firms with high institutional ownership and firms with concentrated ownership pay high and less dividend payout respectively. Abor and Biekpe (2002) on the other hand found that the ownership structure, being inside, family and foreign ownership have significant positive impacts on profitability of SME sector in Ghana in which the corporate governance can greatly assist the SME sector by infusing better management practices, stronger internal auditing, greater opportunities for growth and new strategic outlook through non-executive directors. Disclosing this information can help investors to identify the type of ownership structure in a firm.

5. Accountability & Transparency

A fundamental feature of the information environment is corporate transparency, defined as the widespread availability of relevant, reliable information about the periodic performance, financial position, investment opportunities, governance, value,

and risk of publicly traded firms (Bushman, Piotroski, and Smith 2001)

Corporate transparency measures fall into three categories as highlighted by Bushman and Smith (2003):

- 1) measures the quality of corporate reporting, including the intensity, measurement principles, timeliness, and credibility (that is, audit quality) of disclosures by firms listed domestically,
- 2) measures the intensity of private information acquisition, including analyst following, and the prevalence of pooled investment schemes and of insider trading activities, and
- 3) measures the quality of information dissemination, including the penetration and private versus state ownership of the media.

But the best way to increase transparency is for individual companies to realize that it is in their self-interest to provide the information investors need in valuing the company's shares (Eccles, 2004).

6. Shareholders' Relationship

The shareholders' relationship is very essential as they are the capital providers to the companies. However, there are agency problems involved as the shareholders who act as the principal expect the management who acts as the agent to run the business to increase the shareholders' wealth. Here, the Board exists to solve the classic agency problem that comes from the separation of ownership and control which creates the possibility for management to put their personal interests before those of shareholders (Eccles, 2004).

7. Financial

As stated by Eccles (2004) "Corporate reporting includes financial reporting but it also includes information beyond what regulations require companies to provide to their shareholders and other stakeholders". The companies' management are expected to go beyond regulatory financial reporting requirements and provide more of the kind of information on key value drivers, thereby substantially increasing transparency in corporate reporting. This includes information that is often non-financial in nature and about intangible assets that management is already increasingly using to manage and monitor the company. Obviously such information is equally useful to and desired by analysts, investors and other stakeholders. At the same time, good corporate governance can improve financial reporting when directors and investors demand the information that is rightfully theirs.

8. Human Capital

Knowledge, all of which is created by humans and much of which is embedded in peoples' heads, is

asserted to be the key to competitive advantage and business success (Roberts and Steen, 2000). The authors modelled three different ways of protecting employees' investments. One is by giving employees a claim on the firm's profits. This might come simply through contracts if the returns are verifiable. Whether this contractual solution should be considered as a governance measure is perhaps debatable. A second approach is to empower employees to bargain *ex post* for some of the returns from investments in the firm. This could be achieved by giving them board representation and adopting rules requiring board agreement on the division of the returns. The third is by committing to give employees' interests weight in the firm's strategic decisions, which might also be achieved through board representation. These latter two definitely can be considered governance solutions to the problem of motivating investment. All three approaches can be costly for the original owners, who are giving up some of their returns. Moreover, giving away a share of profits or of decision power typically may weaken the original investors' incentives to acquire physical capital. But as the importance of human capital relative to physical capital increases, the net attractiveness of including human capitalists in governance increases.

9. Community

Hess et al. (2002) opined involvement with the community is the other effective alternative in marketing and reaching the customers and further stated that "competing on price and corporate citizenship is smarter than competing on price alone," in which the firms developed giving plans that were linked to the firm's overall strategy.

The authors view community needs as opportunities to develop ideas and demonstrate business technologies, to find and serve new markets, and to solve long-standing business problems. Structured volunteer programs for corporate employees are a widespread example of this phenomenon demonstrating the mutually beneficial nature of such programs. While the community benefits from the donation of the employee's time and talent, the company benefits from more loyal employees, aid in recruiting, and the teaching of teamwork skills to employees.

Whereas in a recent Ford Foundation Report, it describes corporate investment in community development as a new paradigm likely to "result in a healthier economy and positive business outcomes"

10. Intellectual Capital

Based on statistical analysis, Bukh et al. (2005) provide evidence on the increasing importance of disclosing information on value drivers, strategy and intellectual capital to the capital market. Galbraith

and Merrill (2001) also suggested that information on company strategy is incorporated into investors' decisions, and that information on intellectual capital – especially management experience – does have an effect on the valuation of the company. One of the instruments that have been suggested as a tool both for identifying, managing and reporting intellectual capital and intangibles is the intellectual capital statement. Companies need to invest huge amount of money in making the CSR activities a reality. As such, few companies have argued that the Bursa Listing Requirement would only reduce companies' profit margin without having much benefits to the companies. Here, the government needs to play a bigger role in their efforts to promote the "borrowed virtue"¹ CSR within the companies such as follows:-

- Tax incentives-for sharing the public service burden
- Legislative incentives-requirements from corporations that would provide incentives and benchmarks
- Governments can serve as exemplary institutions though by using socially responsible procurement and personnel recruitment practices
- Transparency at all levels in each stakeholders practices
- Creation of a CSR board-that includes government, civil society, business and academia at country or regional level

Recent Malaysian Budgets have introduced at least eleven special tax incentives in addition to other forms of support which offer significant incentives to companies to pursuit for positive CSR practices. In theory, effective advice can help to create tax efficient and even tax neutral CSR policies which benefit society and minimise cost to companies. There are tax relief opportunities for sponsorship of arts and cultural programmes: capital market graduate training schemes; tax incentives for reduction of greenhouse gas emissions etc. (Geoffrey, 2007)

In fact, many companies use CSR as a way to burnish their image, generate brand equity, and increase employee loyalty. By contributing a certain amount of money in CSR, the companies get full of return of investment much more that make the business sustain. In Malaysia, political issue is very crucial element in delivering business especially for businesses that have the government links and approvals. By doing CSR in fact it could boost the relationship between the companies and the government. If companies can show clearly that their operations are sound in social, environmental and governance terms, so-called "transitional CSR" (Geoffrey 2007), they can prove to investors that they are a sound investment choice. If companies go further to show that they are changing their operations in positive ways to benefit society and

environment they can set themselves out as leaders in the global business community.

Sample

Specifically, this study focuses on information divulged in the annual reports of the country's top 100 public listed companies (PLCs) by market capitalization as at 30th June 2006. However, 5 of the annual reports had not been available (i.e. 1 had merged, 2 had been de-listed while another 2 had only been listed recently) and so had been duly excluded, leaving a final sample of 95 companies. Since many of these companies are also blue-chips counters; which make up the components of Bursa Malaysia's Composite Index, their selection as samples for the current study is very relevant and timely. In fact, these companies are expected to practice relatively higher standards of CSR-based corporate governance compared to other listed companies in Malaysia since they are likely to be of greatest interest to international investors. The 2002 and 2006 annual reports of these companies have either been obtained directly from the organizations concerned or from their respective websites via links from Bursa Malaysia.

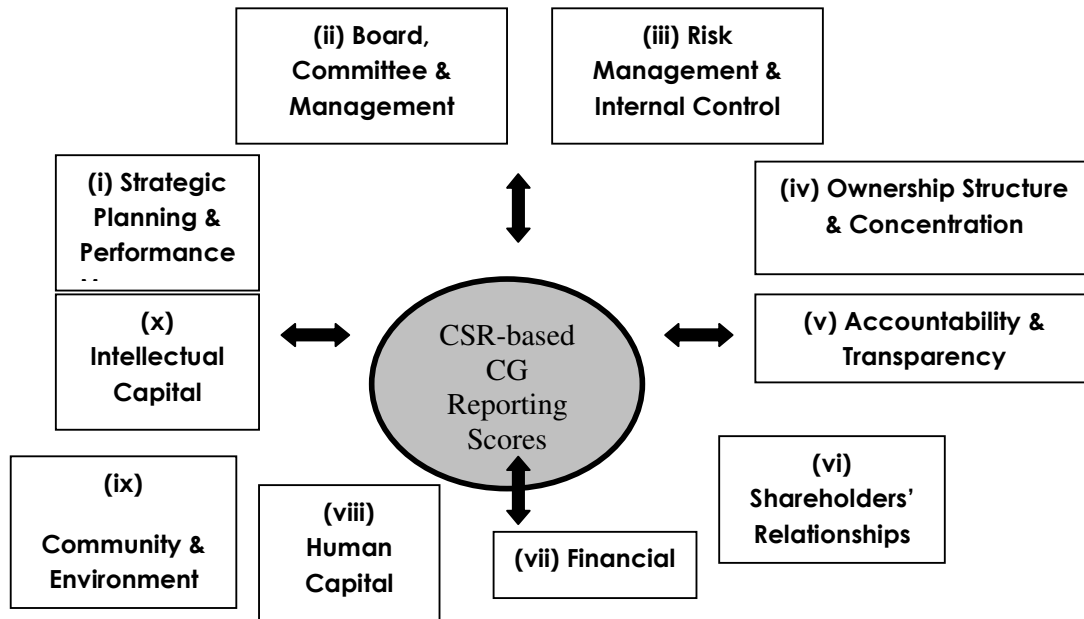
Research Design

A *CSR-based Corporate Governance Score Checklist* is used in ensuring consistency in analysing the annual reports. A set of CSR-based CG attributes had been determined as being not only representative of Malaysia's reality, but simultaneously to emphasise the duality of real-life practicability and world-class quality goals. As a result, a very thorough and comprehensive CSR-based CG model has been developed, based on the CSR and CG requirements of various countries (e.g. the Cadbury Report, the Organisation for Economic Cooperation, the GRI and Development's OECD). In addition, the proposed CSR-based CG reporting framework will also be universally applicable to international markets and acceptable by their investment institutions and relevant bodies. **Figure 1** depicts the 10 principal CSR-based CG attributes used as the main headings for the CG Score Checklist and CSR activities from four main perspectives namely community, education, environment and charity.

Attributes (i), (vii), (viii), (ix) and (x) have been included as a result of the proposed recommendations of worldwide studies on CSR and CG, while the remaining ones have been based on the recommendations of the MCCG. In the meantime, CSR activities are those activities that are specifically spelt out by Bursa Malaysia CSR Framework.

¹ Borrowed virtue CSR policy would reduce profits while raising social welfare (for example, charitable donations of a public company).

Figure 1. Attributes in the CSR-Based CG Score Framework



The study also uses a 5-point Likert Scale to measure the CSR-based CG attributes, a “5-point” score denotes the maximum level of compliance and acceptance of the gauged attributes for CSR-based CG reporting whilst a “1-point” score represents low or no compliance. Based on this, a formatted checklist template has been developed, comprising numerous key attributes and the many variables associated with each of these said key attributes. Each of the variables indicates a score which has been accumulated to provide a classification score associated with each of the said key attributes. For example, “Strategic Planning and Performance Management” consists of 5 variables (statements) with a maximum score of “5-point ” for each variable, resulting in a total score of 25. The maximum possible CSR-based Corporate Governance score that could be allotted to each company analysed is 380 points.

The specific attributes and their respective raw scores for the CSR-based CG reporting used in the survey are shown in **Table 1**.

Each company’s Annual Report was independently read and analysed by two assessors. They would independently sample out companies and compute the CSR-based CG scores of the PLCs and must agree on the final CG scores. It is pertinent that the team minimises the so-called “inter-observation” bias as the reliability of the scores must be kept and be given the utmost priority.

Table 1. CSR-based CG attributes with raw scores

No	CSR-based Corporate Governance Attributes	Total Raw Score
1	Strategic Planning & Performance Management	25
2	Board, Committee and Management	80
3	Risk Management & Internal Control	40
4	Ownership Structure & Concentration	35
5	Accountability & Transparency	75
6	Shareholders’ Relationships	40
7	Financial	25
8	Human Capital	45
9	Community and Environment	10
10	Intellectual Capital	5
Total Raw Scores		380

The discussions on research findings that follow focus on the CSR and CG reporting for financial year ended 2002 and 2006.

Findings

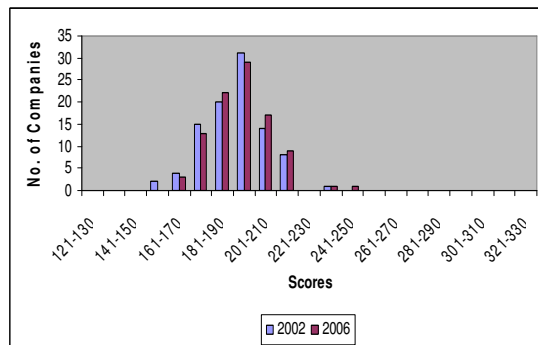
Generally, the current study found that there were widespread differences in the ways in which companies report their CSR and CG practices. While some had reported their CG practices in a particular section, most had chosen to spread the relevant reporting throughout the annual reports, making scoring a difficult task.

The summary statistics on the CG raw scores for the year 2002 and 2006 are shown in **Table 2**, while **Figure 2** shows the distribution of the raw scores for the sample firms.

Table 2. Summary statistics of CSR-based CG scores for 95 PLCs

Item	2002	2006
Sample Size	95	95
Maximum Score	241/380 (63.42%)	256/380 (67.37%)
Minimum Score	149/380 (39.2%)	162/380 (42.6%)
Mean	198.5	209.5
Standard Deviation	17.65	16.93
Median	194	199

As shown in **Table 4.2**, the maximum raw score obtained by the companies in 2006 have slightly increased to 256 (or 66.49%) of the total possible 380 points, as compared to a maximum score of 241 (63.42%) obtained by these companies in the year ended 2002. Similarly, the minimum raw score obtained by the companies in 2006 came up to 162 (42.6%) as compared to 149 (39.2%) in 2002. On average, the companies obtained a raw score of 209.5 or 55.1% in 2006 relative to a raw score of 198.5 (52.2%) in 2002.

Figure 2. Distribution of CSR-based CG raw scores for 95 PLCs for 2002 and 2006

Despite the slight improvement in the total raw scores obtained by the companies, the distribution of the scores is still skewed to the left, as in **Figure 2**. In fact, most of the scores are clustered between 180 (48%) and 210 (56%), reflecting that there is still much room for improvement in Malaysian companies' reporting of their CSR and CG practices.

The following sections report on each of the 10 CSR-based CG reporting attributes.

Strategic Planning and Performance Management

Effectively, the Board must set the direction of the company by formulating its vision, mission and organisational goals. Once these have been identified and drawn up, the company's organisational activities and strategies should revolve around them. Goal congruence between divisions, departments and organisational heads are expected.

Performance measures and key performance

indicators are then set to measure how well these companies meet their objectives and goals. Effectively, companies are also expected to report them in their annual reports.

As such, companies are expected to conform to the following:

- State their vision, mission and organizational goals
- Emphasise on goal congruence
- Identify core competencies
- Conduct interim reviews of their vision, mission and goals
- Distinguish each type of businesses

As shown in **Figure 3**, only 1 out of 95 companies in 2006 obtained 16 points, while majority of them (94 or 98.9%) scored less than 15 (50%) out of the full 25 points. The mean score is 11.6 or 39% of the total possible 30 points. Similar to the results found in the year 2002, the results in 2006 indicate that many companies in Malaysia still do not have comprehensive information on their strategic planning and performance management.

Examining the results further show that all the sample companies in the study failed to disclose the following:

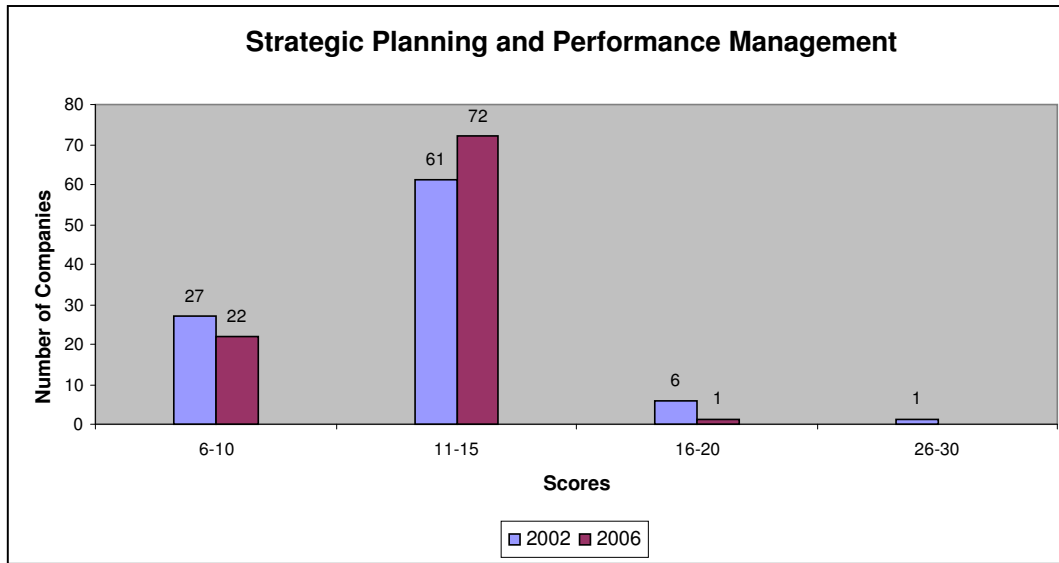
- Emphasise on goal congruence
- Identify core competencies
- Conduct interim reviews of their vision, mission and goals

Board, Committee and Management

The key attribute of "Board, Committee and Management" aims to assess the extent to which the companies' committees and management teams have expedited the process of accomplishing their stated corporate visions, missions and strategic goals. The companies are thus expected to report on the following to their shareholders and other stakeholders:

- Historical developments and significant events taking place within the financial year
- Major decisions made by the Board of directors ("BOD") and management
- Future plans of the companies
- Appointment and re-appointment policies of the BODs and top management
- Communication policies
- Board size and pertinent characteristics
- Directors training
- Succession planning
- Job descriptions of the BOD and management
- Significant issues raised during AGMs/EGMs
- Notes on the various established committees
- Evaluation of the Board members

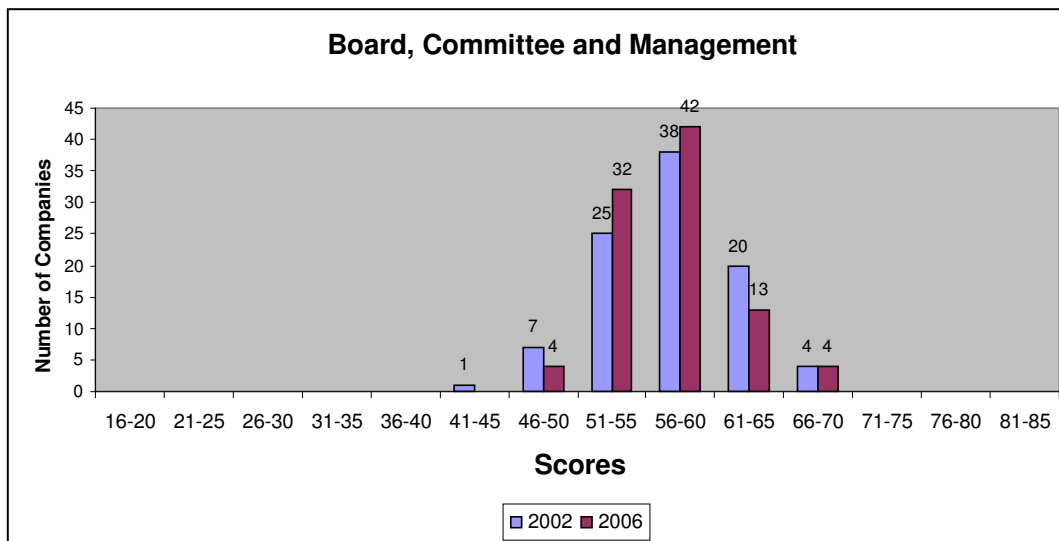
Figure 3. Distribution of CSR-based CG scores for Strategic Planning and Performance Management for 2002 and 2006



The total point achievable in this section is 80: the distribution of the CG scores is provided in **Figure 4**. The overall CSR-based CG scores obtained in 2006 for this attribute are similar to that achieved in 2002. The sample firms obtained scores ranging between 46 and 70 points, where the majority of them

(91 or 96%) scored more than 50 out of the possible 85 points. The mean company score was 57.8 points or 68% of 85 points, indicating an acceptable level of reporting.

Figure 4. Distribution of CSR-based CG scores for Board, Committee and Management for 2002 and 2006



Majority of the companies scored less than 3 points (of maximum 5 points) in areas such as:

- Communication policies within the organisation
- Directors' training
- Job descriptions of the BOD and management
- Notes on Audit Committee's meetings

- Evaluation of the Board members

Risk Management & Internal Control

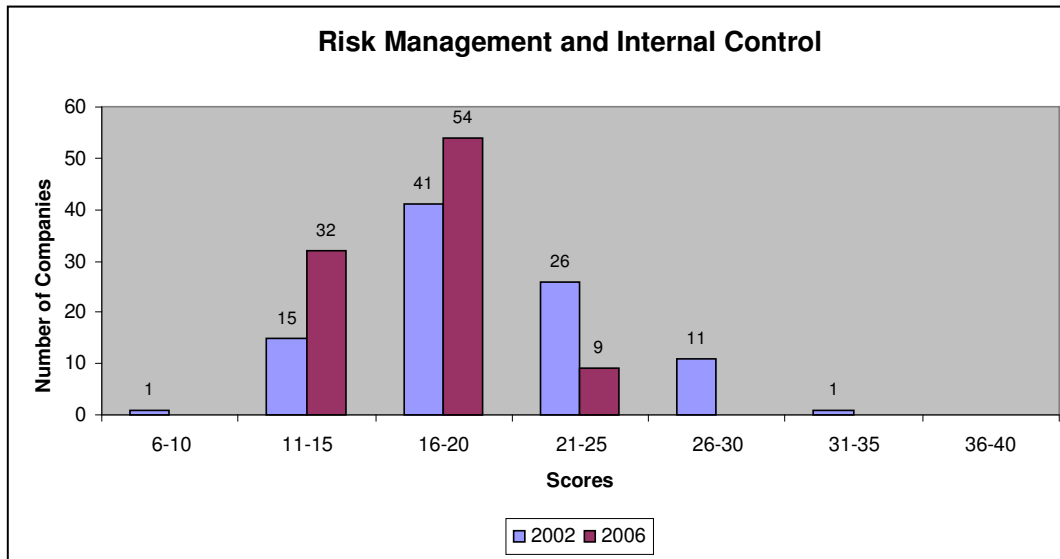
The purpose of developing the "Risk Management and Internal Control" key attribute is to assess the extent to which the companies – through their BODs, committees and management – have taken precautionary measures in managing their business

risks and implementing control systems, as well as reporting them in their annual reports. Among the factors to be continuously reviewed under this category are the following:

- Risk-management framework
- Business risks
- Internal control systems and procedures
- Contingency planning

- Inculcation of risk culture
- Audit compliance
- Audit adequacy
- Internal audit programmes

Figure 5. Distribution of CSR-based CG scores for *Risk Management and Internal Control* for 2002 and 2006



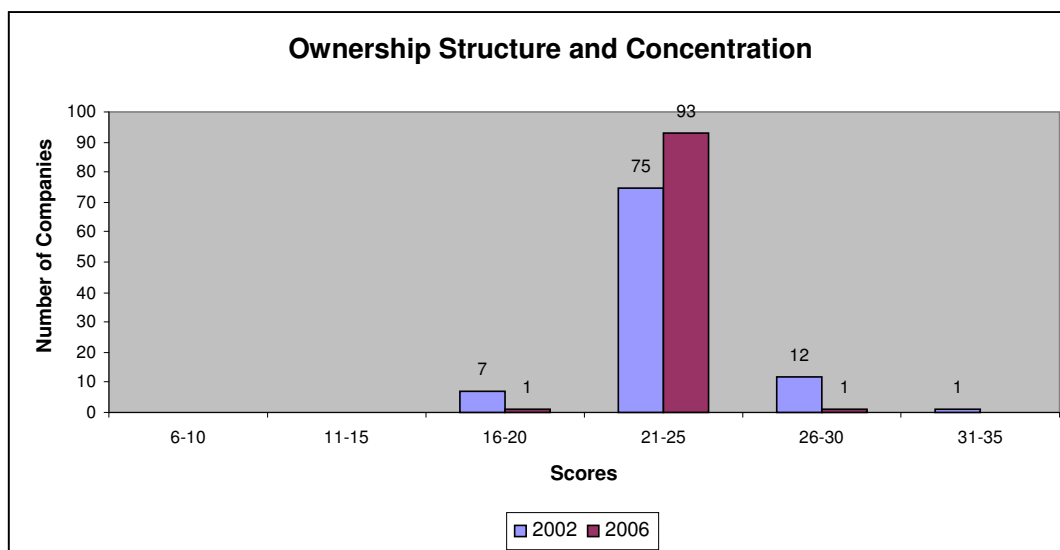
The results obtained by the companies in this attribute for 2006 show not much improvement to that obtained in 2002. The results in **Figure 5** show that only 9 (9.5%) companies scored between 21 and 30 points out of the possible 40 points, while the other 86 (90.5%) scored less than 20 points. The average scores of 16.9 out of the total 40 points (or 48.8%) obtained by the sample firms clearly shows that Malaysian companies have low reporting levels when it comes to risk management and internal control.

Ownership Structure and Concentration

The Code specifies explicit requirements under this heading. For example, 5 of the 13 *Basic Principles* and 13 of the 33 *Best Practices* proposed by the Code dwelt on the issues of “board balance” and a

“balanced ownership structure”. As such, the key attribute of “Ownership Structure and Concentration” assesses the extent to which the BOD creates a “balanced” ownership structure for the company, to protect and enhance the stakeholders’ value. The following information is obviously relevant and must be reported:

- Information on major shareholders
- Shareholdings of the directors and management
- Minority shareholders’ rights and participation
- Information on nominees’ shareholdings
- Share classification

Figure 6. Distribution of CSR-based CG scores for *Ownership Structure and Concentration* for 2002 and 2006

Similar to the results obtained in 2002, the scores in **Figure 6** indicate that a majority of the companies in Malaysia have complied with the Code when reporting information about “Ownership Structure and Concentration” in 2006 as all of them scored more than 16 out of the possible 35 points. However, only 1 company scored 26 points, while the majority (93 or 97.9% of the 95 companies) scored 21 – 25 points (60% - 84%) out of the possible 35 points. The average score of 22.8 of the possible 35 points (or 65.1%) indicates an acceptable level of reporting on “Ownership Structure and Concentration”.

Nevertheless, there is still room for improvement in disclosing the following areas listed below:

- Shareholdings of the directors and management
- Minority shareholders’ rights and participation

Accountability & Transparency

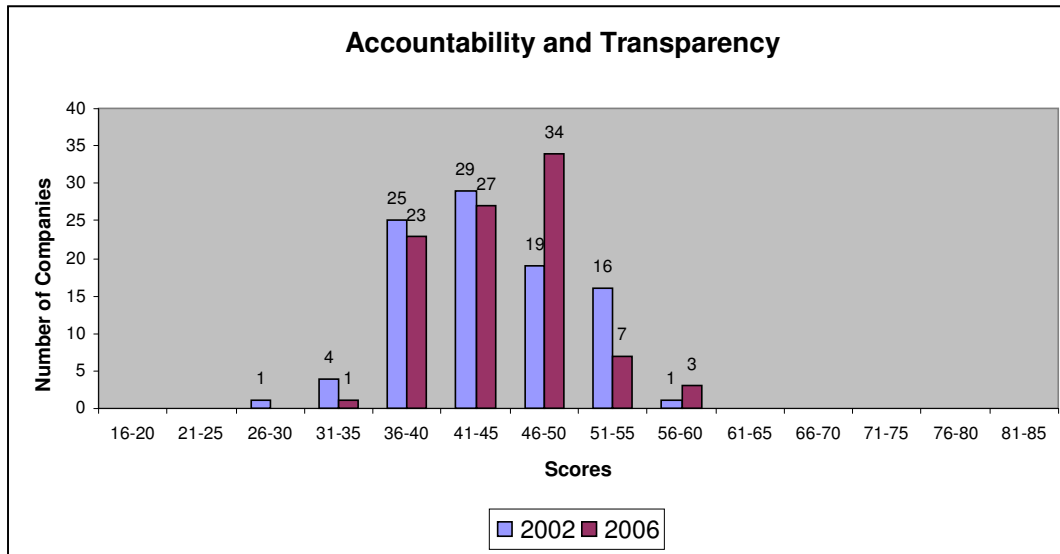
The Code specifies the importance of “Accountability and Transparency” through 3 of its Basic Principles and at least 6 Best Practice items. Effectively, one of the basic responsibilities of a company’s BOD is to be directly accountable to the shareholders. The “Accountability and Transparency” key attribute assesses the extent of the companies’ accountability

and transparency in disclosing pertinent information in their annual reports, including the following:

- External auditors’ recommendations
- Calendar of activities
- Notes on non-audit fees
- Accounting policies
- Interim reviews
- Appointment of professional advisors or company secretary
- Segmental reporting
- Penalties and sanctions
- Directors’ remunerations
- Directors’ assessment of company’s performance

As shown in **Figure 7**, out of the total possible 75 points, 24 out of the 95 companies in 2006 (25.2%) scored less than 41. The majority of the companies (71 or 75%) scored 41 points and above, i.e. 27 companies scored 41-45 points (55%-60%), 34 companies scored 46-50 points (61%-66%), 7 companies scored 51-55 points (68%-73%), and 3 company scored 56 or 74.6% of the possible 75 points. The mean score was 44.6 or 59% of the total 75 points. Similar to the results in 2002, the results in 2006 also indicate that the level of reporting on accountability and transparency is rather low in Malaysia.

Figure 7. Distribution of CSR-based CG scores for *Accountability and Transparency* for 2002 and 2006



Examining the results further show that areas for disclosure improvement include:

- External auditors’ recommendations
- Notes on non-audit fees
- Interim reviews
- Appointment of professional advisors or company secretary
- Segmental reporting for both group and company
- Directors’ remunerations

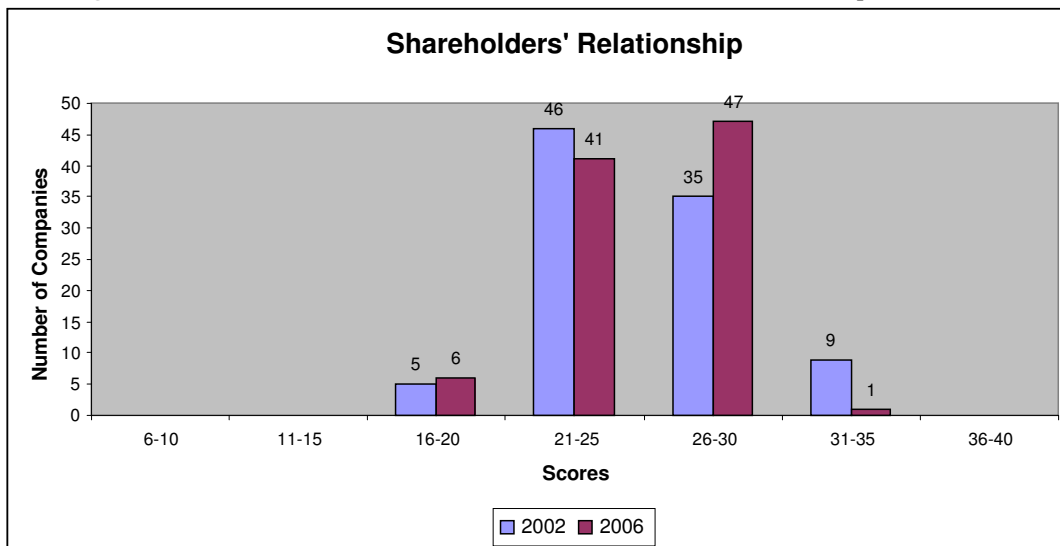
reported these in their annual reports. The relevant information to be included under this category includes:

- Shareholders’ approval for major activities, plans and related-party transactions
- Communication platform between the companies and their respective shareholders
- Voting procedures and shareholders’ rights at AGMs/EGMs
- Shareholders’ proxies
- Accessibility to companies’ information
- Dividend policies.

Shareholders’ Relationship

Specifically, “Shareholders’ Relationship” examined to what extent the BODs of companies have protected the shareholders’ rights and privileges, and have

Figure 8. Distribution of CSR-based CG scores for ‘Shareholders’ Relationship’ for 2002 and 2006



As shown in **Figure 8**, 6 companies in 2006 scored 16 – 20 points out of the possible scores of 40, while the other 89 companies scored 21 - 35 points (52% - 88%). On further examination, 1 company scored 31 points (77.5%), 47 scored between 26 – 30 points (65% - 75%), while 41 companies scored 21 - 25 points (53%-63%) out of the total possible scores of 40. The mean score of 63.6% indicates an acceptable level of reporting on “Shareholders’ Relationships”, similar to the results found in 2002. However, there is still room for improvement in disclosing the following areas listed below:

- Shareholders’ approval for major activities, plans and related-party transactions

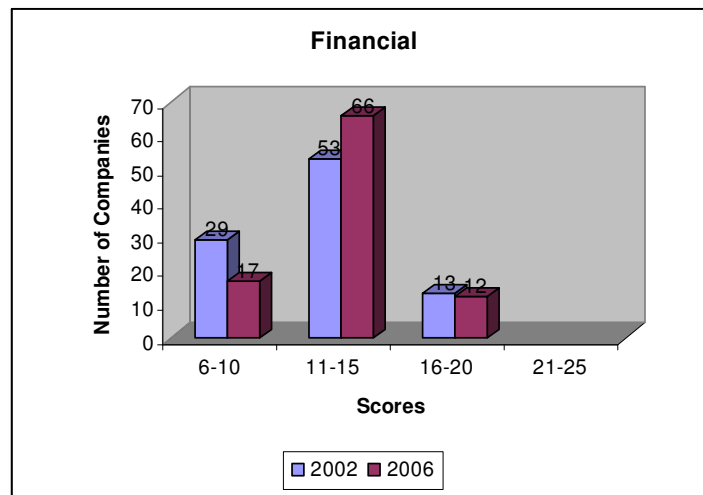
- Voting procedures and shareholders’ rights at AGMs/EGMs

Financial

The “Financial” key attribute has been developed to assess to what extent the management of listed companies has disclosed information on the financial matters of the company. Examples of information implicating such responsibilities include:

- Key Performance Indicators
- Information on Industry Norms
- Financial Forecast
- Notes on Financial Ratios
- Regulatory Requirements

Figure 9. Distribution of CSR-based CG scores for *Financial* for 2002 and 2006



Similar to the results found in 2002, majority of the companies in the sample for the year 2006 have a low level of reporting on “Financial” matters. The evidence is shown in **Figure 9**, where 83 of the 95 sample firms scored less than 15 (60%) of the possible 25 points while only 12 company scored 16 points (64%). Further, the sample firms on average scored 11 points or 44% of the total score of 25 points.

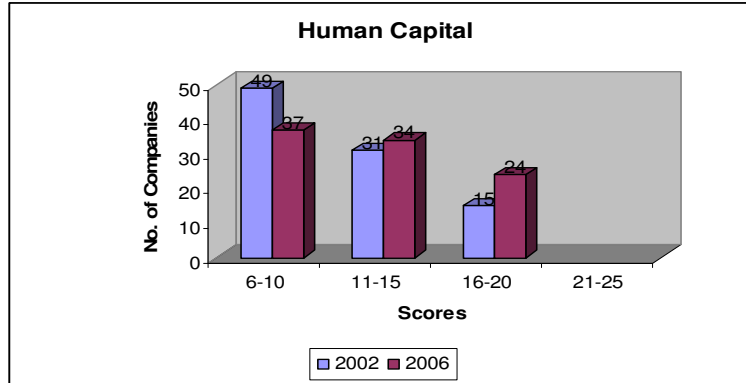
Human Capital

Specifically, “Human Capital” examined to what extent the companies have protected the employees’ rights and privileges, and have reported these in their

annual reports. The human capital, the human centered assets which comprise of the collective expertise, creative and problem solving capability, leadership, entrepreneurial and managerial skills embodied by the employees of the organization need to be disclosed in the annual report. The relevant information to be included under this category includes:

- Notes on company code of ethics
- Employees’ complaint procedures
- Notes on staff disciplinary matters
- Medical benefits and scholarships
- Promotion policies
- Health/safety measures

Figure 10. Distribution of CSR-based CG scores for *Human Capital* for 2002 and 2006



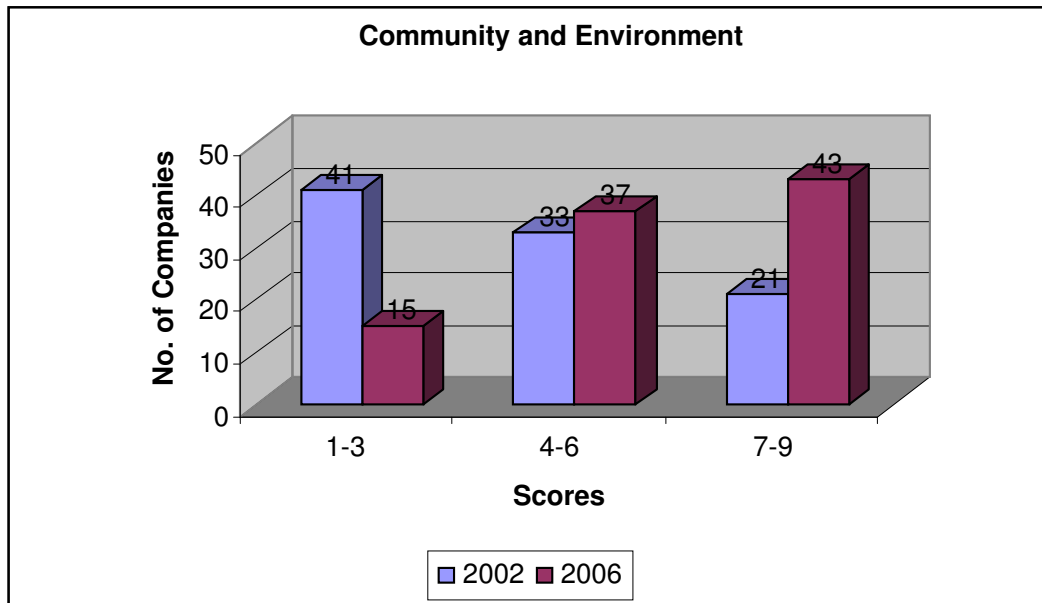
As shown in **Figure 10**, 24 companies in 2006 scored 16 – 20 points out of the possible scores of 45, while 34 companies scored 11 - 15 points. The mean score of 33.6% indicates a very low level of reporting on “Human Capital”, similar to the results found in 2002.

Another important attribute to be reported by the company is information on *Community* or efforts taken by the company on its corporate social responsibility. Examples of information reported under this category include:

- Donation
- Public perception on the company’s image
- Plans on both community and environmental related activities

Community and Environment

Figure 11. Distribution of CSR-based CG scores for *Community and Environment* for 2002 and 2006

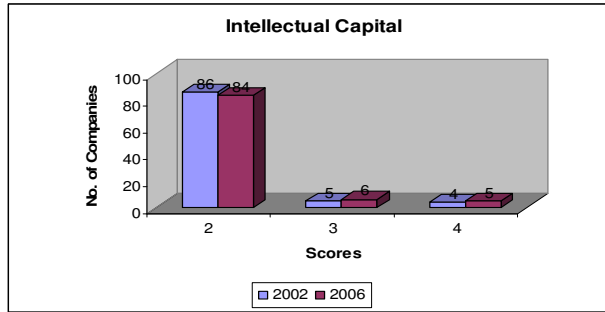


As shown in **Figure 11**, out of the total possible 10 points, 15 out of the 95 companies in 2006 (15.8%) scored less than 4 points. The majority of the companies (80 or 84%) scored 4 points and above, i.e. 37 companies scored 4-6 points (40%-60), and 43 companies scored 7-9 points (70%-90%) of the possible 10 points. The mean score was 6.8 or 68% of the total 10 points. Similar to the results in 2002, the results in 2006 also indicate that the level of reporting on Community is quite satisfactory in Malaysia.

Intellectual Capital

Intellectual capital (“IC”) represents one of the most important assets of an organisation. Though not easily measurable, the BODs must take proactive steps in highlighting them in their annual reports, which are effectively represented by item such as Efforts in enhancing intellectual capital efficiency

Figure 12. Distribution of CSR-based CG scores for *Intellectual Capital* for 2002 and 2006



Similarly, all companies in the sample have low levels of reporting on IC, as shown in **Figure 12**. Similar to the results found in 2002, all of them scored less than 50% of the possible total score of 10 points where majority of the companies, i.e. 84 companies scored 2 point. The mean score was 2.6 points or 26% of the total 10 points, indicating a very low level of reporting.

Findings Summary for 2006

A summary of the distribution of the mean percentage raw scores across the 10 main attributes for CSR-based CG reporting is shown in **Figure 13**, and the results in 2006 are similar to that found in 2002. Based on the percentage raw scores, the companies on average scored more than 50% for the following attributes:

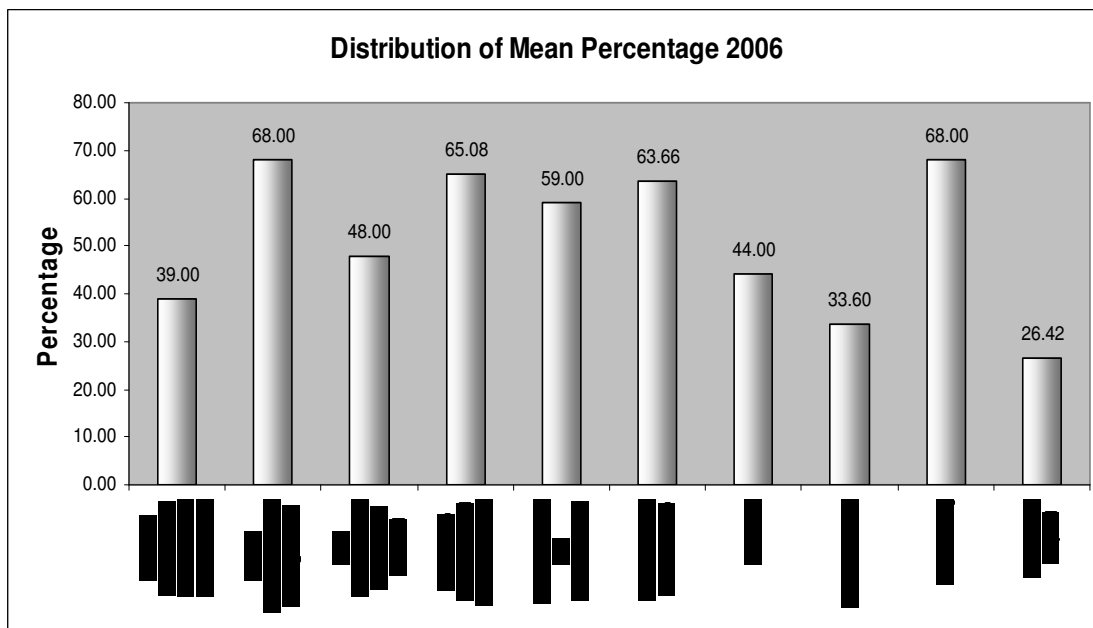
- ✓ Board, Committee and Management
- ✓ Ownership Structure & Concentration
- ✓ Accountability & Transparency

- ✓ Shareholders' Relationships
- ✓ Community

The mean percentage in CSR-based CG reporting for “Risk Management & Internal Control” is slightly less than 50%, which indicates that companies in Malaysia have a very low level of reporting on this attribute despite the specific requirements in the Code.

In addition, the percentage scores for attributes like board committee and management, risk management, ownership structure, accountability/transparency, as well as stakeholders' relationship are higher than the percentage scores for strategic planning, business ethics and intellectual capital. The better disclosure of information on the former categories in comparison to the latter seems to indicate more corporate familiarity with the better-disclosed topics, possibly due to their focus on the MCCG and compliance with the listing requirements of Bursa Malaysia.

Figure 13. Distribution of the mean percentage CSR-based CG reporting scores for the 10 key attributes for 2006



Even though human capital, community and intellectual capital are globally recognised as critical corporate issues under CSR, much less disclosure has been presented here. One possible reason may be that Malaysian PLCs are still focusing too much on issues that are required to be disclosed by the legislation, rather than divulging information that will be useful to the investing public. In a nutshell, the overall results for the CSR-based CG reporting initiative 2006 have shown that the self-disclosure based regime behaviour of these companies have not altered much since 2002.

Scores and Rankings

Further, each principal attribute had been assigned weights to denote their relative importance. Basically, a higher weight has been given to those requirements specifically spelt out by the Code and Bursa Listing Requirements. Items that are not particularly deliberated on by the Code or the Listing Requirements such as information on CSR have been given slightly lower weights. This is evidenced for attributes 1, 7, 8, 9 and 10. The objective is to encourage the listed firms to benchmark their CSR-based CG reporting against the world's best practices and perform better over time without penalizing their non-conformance at the current stage. A percentage was then computed with 100% being the perfect score, as shown in **Table 3**.

Table 3. CSR-based CG attributes with their respective weights

No	CG Attributes	Weights (%)
1	Strategic Planning & Performance Management	5
2	Board, Committee and Management	15
3	Risk Management & Internal Control	15
4	Ownership Structure & Concentration	15
5	Accountability & Transparency	15
6	Shareholders' Relationships	15
7	Financial	5
8	Human Capital	5
9	Community	5
10	Intellectual Capital	5
Total Weight Scores		100

Based on the weighted scores for each attribute, the rankings of top 20 of the 95 listed firms in the sample for the year 2006 are highlighted in **Table 4**.

Table 4. Rankings of top 20 PLCs based on CSR-based CG reporting scores in 2006 (in alphabetical order)

No	Company
1	Bintulu Port Holdings Berhad
2	Carlsberg Brewery Malaysia Berhad
3	DRB-Hicom Berhad
4	Edaran Otomobil Nasional Berhad
5	Highlands & Lowlands Berhad
6	Kumpulan Guthrie Berhad
7	Malakoff Berhad
8	Malayan Banking Berhad
9	Malaysia Airport Holdings Berhad
10	Maxis Communications Berhad
11	MK Land Holdings Berhad
12	Petronas Gas Berhad
13	PLUS Expressways Berhad
14	Public Bank Berhad
15	Puncak Niaga Holdings Berhad
16	Sime Darby Berhad
17	Telekom Malaysia Berhad
18	Tenaga Nasional Berhad
19	UEM World Berhad
20	UMW Holdings Berhad

Further analysis shows that Malayan Banking Berhad ("Maybank"), Tenaga Nasional Berhad

("Tenaga") and Telekom, ranked the top 3 by market capitalization, are in the top 20 companies by CSR-based CG reporting scores in 2006. In fact, there are

instances where some companies have improved their reporting scores in 2006 relative to that in 2002. For example, Telekom has improved tremendously from a CSR-based CG Reporting score of 60.07% in 2002 to a score of 65.54% in 2006. Areas of improvement include:

- Board, Committee and Management
- Ownership Structure and Concentration
- Accountability and Transparency
- Stakeholders' Relationship
- Community and Environment

However, it is important to note that there is little variation in the scores of the 95 companies in the sample over the 4-year period: the lowest-ranked company obtained a CG reporting score of 43.79% and the highest-ranked one scored 64.74%, while on

average the companies scored 51.91%. In fact, there is a slight difference in the attributes between the companies in the top 20 positions and the other 75 companies: the results are shown in **Table 5**.

As highlighted in **Table 5**, the top 20 companies recorded high overall CG reporting scores in all attributes relative to the other 75 companies. However, there is a slight variation in the scores between the 2 groups. The biggest difference in scores is only about 1% - 2% for the following attributes:

- ❖ Board, Committee and Management
- ❖ Risk Management and Internal Control
- ❖ Accountability and Transparency

Table 5. Comparison of attribute scores between the top 20 companies and the other 75 companies

	Attributes	Weight			
			Top 20	Other 75	Difference
1	Strategic Planning and Performance Management	5%	2.17	1.88	0.29
2	Board, Committee and Management	15%	10.86	9.86	1.00
3	Risk Management and Internal Control	15%	7.35	6.09	1.26
4	Ownership Structure and Concentration	15%	9.92	9.72	0.20
5	Accountability and Transparency	15%	11.93	10.12	1.81
6	Shareholders' Relationship	15%	10.09	9.41	0.68
7	Finance	5%	1.45	1.35	0.10
8	Human Capital	5%	1.67	1.46	0.21
9	Community and Environment	5%	3.02	2.25	0.77
10	Intellectual Capital	5%	1.57	1.26	0.31
	Overall	100%	56.90	50.58	6.32

Conclusion

The main focus of the study is to provide useful starting points for companies to identify areas for improvement. The results of the study reveals that there is much room for improvement vis-à-vis Malaysian companies' reporting of their CSR and CG practices, as the average CSR-based CG reporting score of these sample firms in 2006 and over the five year period (2002-2006) only came up to 52.2% and 55.5% respectively. Furthermore, CSR-based CG reporting has been found lacking mainly in areas such as Strategic Planning and Performance Management, Risk Management and Internal Control, Financial Matters, Human Capital, and Intellectual Capital. As such, Malaysian companies must take proactive steps in enhancing the reporting of their existing corporate programmes.

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