

## THE INFLUENCE OF CULTURAL VALUES ON THE BOARD OF DIRECTORS: LESSONS FROM FIVE CORPORATIONS

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### Abstract

The Malaysian Code of Corporate Governance 2000 emphasises the monitoring role of the Board of Directors, especially that of independent directors. It has not however taken into account the cultural values in Malaysia which do not encourage differences of opinion or criticisms and has failed to provide sufficient safeguards for directors to exercise their role effectively. As a result, it is relatively easy for dominant Chairmen or CEOs especially in government-linked companies or CEO dominated companies to control the Board or senior management with very little opposition. This paper will discuss several incidences of financial mismanagement in companies caused by dominant directors with very little opposition from the rest of the board. It will highlight that the law has to take cultural values more seriously in order to equip the Board and especially independent directors with the ability to challenge dominant Board members.

**Keywords:** Board of Directors, Cultural Values, Chairman/CEO Control

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### Introduction

The Malaysian Code of Corporate Governance 2000 (MCCG) subscribes to the agency theory by emphasising the monitoring role of the Board, especially independent directors (INEDs). The Code was enacted by the High Level Finance Committee on Corporate Governance (Finance Committee) formed by the Malaysian Government to establish a new framework for corporate governance when it became clear that poor governance had contributed to the Asian Financial crisis (Kim, 1998). The Finance Committee referred to the literature in British and American jurisdictions which justified the increased role played by an independent Board based upon the agency theory (Clarke, 2007; Cox 2003) and designed the MCCG along similar lines. The MCCG applies a 'comply or explain' best practice rule intended to assist corporations in designing their own approach to corporate governance (Clarke, 2007). When transplanting the provisions of the MCCG which were based on the United Kingdom Hampel Report and Combined Code, the Finance Committee referred to specific problems faced by boards such as dominance of the Board by Chairmen who were founders of the corporation, politically connected or members of royalty. The problem is acute in the Malaysian capital market where many corporations are either family or government owned. When this is viewed in light of cultural values in Malaysia, the consequence is that

the rest of the board including INEDs are rarely able to withstand directors who are dominant personalities or those with political connections. There is a need to ensure that laws take this into account.

### ***The nomination committee's role in selecting INEDs***

The Board of Directors of a corporation is required to participate in the decision making process and monitoring tasks (Cox, 2003) but INEDs have a special role to monitor the Board and management effectively as executive directors (EDs) are involved with daily operational details that may tend to undermine their monitoring responsibilities and non-executive directors (NEDs) may represent interests of certain and not all shareholders. The appointment of INEDs has been one of the main responses to CEO dominance and agency problems (Clarke, 2007) as a CEO dominated board affects its efficiency (Shivdasani and Yermack, (1999). They are also expected to carry out unbiased oversight of management and the Board to detect and prevent mismanagement (Sale, 2006). In addition, they must warrant that the Board and management carry out their duties in the most efficient and effective manner without negligence thus enhancing corporate performance because they can proactively examine corporate affairs (Fairfax, 2010). The extent to which INEDs perform their duties well depends upon their

level of independence (Fama, 1980; Fama and Jensen, 1983), their degree of knowledge and skills (Hendry, 2005) and the authority given to them under capital market regulations to carry out their role. In addition to these important requirements cultural values in society play a part in directors' ability and willingness to perform their role; a factor which is often ignored.

A plethora of codes recommend appointing more INEDs on the board to safeguard corporate responsibility, provide oversight of a corporation's financial reporting practices (Persons, 2006) and protect shareholder interests (Hermalin and Weisbach, 2003). The expectation that transparency and accountability will increase with independence of the Board is so pervasive that INEDs have been placed in important roles on Board Committees namely the nomination, remuneration and audit committees. The MCCG recommends that the role of INEDs is increased through similar committees.

The key task of the nomination committee is to ensure that the corporation recruits and retains the best available executive and non-executive directors. Powerful CEOs or Chairmen rather than shareholders, often select directors (Van Ees and Postma, 2004) which may result in a board that is more amenable and compliant (Hermalin and Weisbach, 1988) although this is not in line with the MCCG. Shareholders may have the final vote in electing directors to govern the corporation, but are often cornered into either accepting the proposed candidates or initiating a proxy challenge which is time consuming and costly (Vafeas, 1999). It is therefore important to have a nomination committee that is independent from senior management and powerful enough to make independent recommendations to ensure that directors appointed to the board possess the necessary skills and leadership to accomplish their roles (Ruigrok, Peck, Tacheva, Greve and Hu, 2006) and also to prevent board domination by individuals or certain groups.

Although the role of INEDs on board committees is emphasised in the MCCG, no other code or legislation regulating the Malaysian capital market emphasises their role. As the MCCG applies on a 'comply or explain' basis, corporations often have nominal committees without reporting whether these committees are working in an effective manner. There are no legal sanctions for failing to operate effective board committees although audit committees provide more comprehensive information in annual reports due to Bursa Malaysia's Listing Requirements.

### ***Threats to independence of INEDs***

Conventional wisdom dictates that INEDs play a large role in corporate governance but there is no common definition of 'independence' in relation to directors in Malaysia (Brudney, 1982). The most common term that defines 'independence' is in Bursa Malaysia's

Listing Requirements which defines independent directors as persons without a business or family relationship that will be deemed in conflict of interest with the corporation (Borowski, 1982). From this stance, INEDs must not be employees of the corporation, outsiders who have a substantial economic relationship with the corporation or family ties with its management or other directors (Zattoni and Cuomo, 2010). However it is difficult to find a method of ensuring independence in substance over form.

At times INEDs serving on the Board longer than usual will form opinions about other directors on the Board and may even develop friendships which may affect their independent judgement even if they fulfil the legal definition of an independent director (Adams and Ferreira, 2007; Hwang and Kim, 2009). This creates structural bias which makes it difficult for them to arrive at fair and objective assessments (Elson and Gyves, 2003). "Structural bias" refers to bias resulting from board members' familiarity and ongoing interactions with each other after joining the board (Velasco, 2004). When working together as a group, board members tend to form collective alliances. Hence, it is noted that structural bias can have a big effect on decision-making within the boardroom, spurring board members to protect each other from legal sanctions (Cox and Munsinger, 1985). Similarly, structural bias could undermine directors' ability to be critical towards their fellow directors. Enron's Board was an example of a homogenous and highly cohesive group that had a strong affiliation to each other especially as most of the board members had served for extended terms (O'Connor, 2003).

Another threat to independence is 'group think' which is where Boards technically comply with Listing Requirements and the definition of 'independence' but recruit members from a close circle of friends or supporters resulting in directors' reluctance to raise questions and scrutinize performance of the Board (Hwang and Kim, 2009). 'Group think' poses a major problem in the Malaysian capital market (Lin, 2011). Bursa Malaysia's Corporate Governance Guide (BM CG Guide) warns against mixing collegiality with blind conformity while the Corporate Governance Blueprint 2011 (CG Blueprint) issued by the Malaysian Securities Commission highlighted it as a major problem with the definition of 'independence'. The CG Blueprint 2011 stressed on board diversity such as different ethnicity, gender and nationality to prevent 'group think'.

Although structural bias and group think is common to all directors regardless of whether they are independent or executive directors, it is particularly acute where INEDs are concerned as the whole purpose underlying their appointment is to bring fresh views without bias or influence of other directors.

## **Cultural Values**

The problems with structural bias and group think are faced by corporations in all societies but are compounded by cultural values in Malaysia. Power distance collectivism and assertiveness are some of the cultural values that may prevent directors from carrying out their role effectively.

### **Power distance**

Hofstede defines power distance as ‘... the extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally.’ (Hofstede, 2005; p46) This refers to the interpersonal power of influence between two people as perceived by the less powerful (Hofstede, 2001; p83). If the powerful person’s power can be exercised at his or her whim and the powerless person cannot really resist, then power distance is said to be high.

The level of power distance in a particular society can be used to measure the authoritarianism prevalent in that society. When a person is invested with power, there is a tendency to identify with this power and to increase the distance between himself or herself and the people without this power. The greater the power distance between the two, the more the powerful person will try to increase it and the less the powerless person will resist it. If the power distance between the two people or groups was never great to begin with, the person with less power will struggle more to reduce the distance (Mulder, 1977).

Many relationships are divided into the more powerful and less powerful. Those who have power are entitled to privileges and use their power to accumulate more wealth and in turn more power while the less powerful are not used to enforcing their rights. The social aspect of power distance reveals that power and inequality in society is accepted as the norm in societies with high power distance and the type of power exercised is coercive power and power based upon the power-holder’s charisma. The powerless are deferent towards the powerful and this is inculcated into society (Hofstede, 2001; pp100 – 113). Power distance can also be described as the way in which people within a particular culture deal with inequalities.

Cultures where power is exercised through coercion and to pursue personal goals have high power distance. McClelland referred to two ways in which power can be exercised. The first is where power is personalised to obtain dominance and pursue personal goals. The second is where it is used to further the goals of groups (McClelland, 1970). In cultures where power distance is high there is little resistance to power that is personalised. It is up to the powerful in those cultures whether they wish to exercise their power to further the goals of the group. In societies with low power distance practices, the

powerful are expected not to exercise their power arbitrarily to promote their own ends (Hofstede, 2005; p46).

Hofstede’s Power Distance Index Values for 53 Countries and Three Regions (known as the PDI index) has an average score of 57. Malaysia had a score of 104 which shows a high level of power distance. However the Global Leadership and Organisational Behaviour and Effectiveness Research Programme (GLOBE) which was conducted recently shows that Malaysia’s score for power distance was 5.17 which was also the average score. This shows that power distance exists in Malaysian society albeit not at very high levels.

The Finance Committee commented in the prelude to the MCCG that there was a tendency for Boards to be dominated by powerful Chairpersons due to their social status, political links or because they were the founders of the corporation. The MCCG recommended separation of the role of Chairman and CEO but did not prevent the Chairman or CEO from becoming a member of important board committees, for example the audit committee although it recommended that INEDs should form the majority of the audit committee. This is not ideal in a society where there is deference to well-connected or dominant personalities which could result in board committees that are complicit with the CEO or Chairman’s directives even if it transgresses good governance. In other words the MCCG did not do enough to prevent dominant Chairmen or directors from being in a position to manipulate the Board.

### **Collectivism**

In-group collectivism which refers to great loyalty to family members and in-groups is pronounced in Malaysia which obtained a score of 5.51 which was above the average score of 5.13 in GLOBE’s study (Gelfand, Bhawuk, Nishi and Bechtold, 2004). In societies with high in-group collectivism, a sense of belonging to an ‘in-group’ is important and therefore conflicts are ‘swept under the carpet’ and in most cases face-to-face confrontations are rare (Triandis, 1988). Criticism is not deemed to be constructive unlike in less collectivist societies. The concept of maintaining ‘face’ is important and criticism is often seen as a weapon used by the critic to cause ‘loss of face’ to the person being criticized (Ho, 1976). Those who have opinions that differ from their group are expected not to air their views but to remain loyal to their own group and treat those within their own group better than those outside the group (Hofstede, 2001; p227).

Triandis states that the culture of a society influences how people within that culture view their ‘self’. If a culture is collectivist then it influences people to view the public and collective self more than their private self which means that they are more concerned with how others perceive them (Triandis,

1990). In Asian cultures, where people are interdependent there is a greater tendency among people to perceive themselves in light of their public and collective self (Triandis, 1989). People in collectivist cultures behave according to norms and interests of in-groups and value in-group goals (Hofstede, 2005). They are interdependent because of their definition of 'self' and will accept a high level of demands from their in-groups. Social relations are more enduring and occur in large groups. They also value in-group goals and often place these goals over their personal goals. For example, if family members are seen as in-groups, the goals of these members will take precedence over the individual's goals. Their sense of duty guides them towards observing social norms and they are less concerned with personal attitudes and values (Triandis, Leung, Villareal and Clark, 1985). For these reasons directors in Malaysian companies may face difficulties in presenting views that differ from the majority especially when they differ with the Chairman or CEO.

### **Assertiveness**

The level of assertiveness in a society reflects willingness of individuals to assert their views and to speak up about issues that they are concerned about. Cultures with low levels of assertiveness generally view assertiveness as socially unacceptable and value modesty. These cultures emphasise 'face-saving' and indirect speech when dissenting with others and also emphasise tradition, seniority and experience. In such cultures, a person's status is important and respect is accorded to those with high status.

Trompenaars and Hampden-Turner studied various societies' adaptability to their surroundings and found that societies have two orientations towards nature which determines their level of assertiveness. They either believe that they can control and subjugate their surrounding environment or they have to maintain harmony with it and sometimes subjugate themselves to it (Trompenaars and Hampden Turner, 1997). Societies in the former category are 'inner directed' or internal because they look within themselves to take charge and actively control their environment (Schein, 1992). Control is often exerted through science. Societies in the latter category are 'outer-directed' or external as they believe in a supernatural being that controls nature.

Trompenaars' and Hampden-Turner's studies reveal that most Western societies fall into the former group and Asian societies fall into the latter group. A society's cultural orientation towards nature affects the manner in which that society conducts itself on a day-to-day basis. Where a society believes that it has to maintain harmony and subjugate itself to nature, it will try to assert itself in a manner that is not aggressive. Societies that believe that they can control nature by obtaining knowledge about the laws of the universe and using it to control their surroundings are

assertive to the point of being aggressive. Such societies thrive on competition. The focus is on 'self' and conflict and resistance are seen as part of controlling ones' destiny. Their research reveals that Western societies are more assertive while Asian societies believe that maintaining peace and compromising in order to maintain peace is a sensible way to approach life, as there is no point in fighting forces over which one has no control. However as societies become developed, they do not subscribe to the concept that they should subjugate themselves to nature but seek to control it instead and in the process become more assertive (Den Hartog, 2004). GLOBE's study indicated that Malaysia's level of assertiveness is 3.87 and is below the average global level of 4.14 which reflects that submissiveness is strong cultural trait.

The levels of power distance, collectivism and assertiveness in Malaysia poses a challenge to the board as a whole and the independence of INEDs as it supports group think and structural bias although independent directors are meant to be free of such influence. Directors who are assertive and refuse to acknowledge the status or power of the Chairman or CEO may not be re-elected on the grounds that they are not team-players. In a similar manner, low levels of assertiveness in Malaysia means that individual directors may be reluctant to assert their role as monitors of the corporation especially in government-linked or family owned corporations. These cultural values could hamper the role of directors even in non family or government owned Malaysian corporations (Fontaine and Richardson, 2005).

### **Cultural Values and Compliant Boards: Lessons from Five Corporations**

In recent years there have been instances of corporate mismanagement due in part to poor board oversight. The following discussion will emphasise the boards' in particular INEDs' failure to highlight financial mismanagement although there was evidence pointing to its existence. The mismanagement was due to a variety of reasons which the board may not have been able to prevent. The discussion will only highlight the contribution of high power distance, in-group collectivism and lack of assertiveness in government linked and non-government linked companies which resulted in compliant boards.

Government linked companies refers to companies which have government investment agencies as substantial shareholders. This occurred in the 1980s when state enterprises were privatised as part of an exercise undertaken by former Prime Minister Mahathir Mohamed, to create Malay capitalists. Malay individuals identified by the government were given management and control over privatised state enterprises as a wealth creation exercise. The result was that GLCs approximated almost 40% of market capitalization and a class of

Malay capitalists who had close ties with politicians was created (Tan 2008: 56-57, Gomez and Jomo 1999: 81-87). Family-owned companies also comprised a considerable approximation of the capital market in common with other Asian capital markets (Lim, 1981; p113). In light of the ownership structure of many corporations in Malaysia, there is a greater likelihood of the existence of structural bias and group think. A study of the top 20 corporations in 2010 in Malaysia according to market capitalization excluding banks and financial institutions revealed that many directors including independent directors had served on the board of the same corporation for an average of 19 years (Yong, 2011). The annual reports of GLCs in 2010 also revealed that a large section of the board in these corporations comprised male Malay directors whereas ethnic Chinese family-owned corporations had boards comprising mostly male Chinese directors.

There are many instances of GLC boards that were not assertive enough to withstand powerful CEOs especially if they were aligned to politicians. Proton, Malaysia's national car-maker was the brain child of former Prime Minister Mahathir Mohamed who continued as Proton's advisor even after his tenure as prime minister ended in 2003. In 2005 the CEO of Proton who was widely regarded as Dr Mahathir's appointee made a decision to acquire MV Agusta a motorcycle manufacturer for RM 370 million in order to use Agusta's technology (K Hepworth, 2004). Proton spent approximately RM500 million to start the project before deciding a year later to sell MV Agusta for RM 4.48 (1 Euro) to Italy's Gevi SpA on the grounds that Agusta was on the verge of declaring bankruptcy which would expose Proton to a debt of RM256 million (Moses, 2006). The Board of Proton stated that they were unaware that Agusta was in debt when they purchased it or that a cash advance was made without controlling rights although Proton owned more than 50% shares in Agusta. They also claimed that they were misled into believing that the cash advance was working capital meant to be used to manufacture motorcycles although it was used to settle Agusta's debts. Dr Mahathir argued that the main shareholder of Proton, Khazanah Nasional, a government investment agency had agreed to the purchase of Agusta and it had been discussed by the Board. However one of the former Board members stated that the decision was sent by the CEO 'straight to the top' referring to the government, bypassing the Board (Abdullah, 2006)

Sime Darby (Sime) is another example of a government linked corporation where the dominant shareholder, Permodalan Nasional Berhad, controlled the selection of executive directors including the CEO. In 2010 Sime disclosed losses incurred due to cost overruns from the Bakun Hydroelectric Project and both of its Qatar Petroleum (QP) and Maersk Oil Qatar (MOQ) projects which amounted to almost RM 2 billion. Sime's internal auditor issued a report in

2008 on the losses incurred by the oil and gas segment which was brought to the attention of the audit committee but the losses were deemed immaterial after the committee requested an explanation from the CEO. No further investigations were conducted although its external auditor delayed signing off on the accounts. Sime also denied reports of cost overruns of RM800 million in 2009 even though its internal auditor issued another report voicing grave concerns over losses in the oil and gas segment. In 2010 its external auditor recommended to Sime's Chairman, a former deputy Prime Minister of Malaysia that it was necessary to form a working group to investigate the extent of losses. It was discovered that although the Board was aware of the situation, they relied on Sime's CEO's explanation regarding the delays in the project and the cost overruns (Ng, 2010).

Malaysia Airlines (MAS) another government-linked company suffered losses amounting to RM 8 billion when it was under the control of its executive chairman Tajuddin Ramli who was appointed by the government. He obtained controlling interest over the airline in 1994 by obtaining a personal loan from a syndicate of local banks amounting to RM 1.79 billion to purchase MAS shares from the Central Bank. During this period he relocated MAS cargo operations in Europe from Amsterdam and Frankfurt to Hahn through Advanced Cargo Logistics Centre, a company that was connected to his family. This proved to be inefficient as cargo had to be transported by land to Frankfurt for customs clearance. As Hahn was not equipped to deal with large aircraft, outgoing cargo was transported on smaller aircraft resulting in losses amounting to RM10 to 16 million per month (Jayasankaran, 2010). In 1998 Tajuddin sold MAS aircraft to MAS Capital a new company under his control. MAS Capital leased back the aircraft to MAS. The book value of the aircraft was RM 9.5 billion but due to the depreciation of the ringgit, its actual value amounted to RM14 billion. MAS Capital refinanced the aircraft and used the surplus to pay Tajuddin a combination of cash and shares amounting to RM 739 million for stake in two of his companies. The sum paid to Tajuddin was used to clear part of his personal debt. When objections were raised by investors former Prime Minister Dr Mahathir stated publicly that this was a normal process (Pereira, 1998). In 2001, the government re-nationalised MAS by purchasing Tajuddin's stake at the same price at which he had bought it from the Central Bank although the market value was less than half that amount. Tajuddin failed to service his personal loan to the syndicate of banks and the non-performing loan was purchased by Pengurusan Danaharta which was established by the government to deal with non-performing loans during the Asian financial crisis. Danaharta was awarded RM589 million by the High Court and in his defence, Tajuddin claimed that he was asked by Mahathir and former Finance Minister

Daim Zainuddin to purchase MAS in 1994 in order to rescue the Central Bank which had suffered losses in currency trading. In August 2011, the government instructed Danaharta and all other government linked companies to cease civil action against Tajuddin on the grounds that they wanted to pursue an out of court settlement (Ng, 2011). The major decisions in MAS appear to have been made by the Chairman, Tajuddin and the government with little reference to the Board.

The failure to question powerful CEOs or Chairmen is not peculiar to government linked companies. In the last 5 years, there have been multi-million ringgit losses in several Malaysian corporations namely Linear, Kenmark and Transmile due to fraud or mismanagement. These corporations had several things in common namely the founders remained on the Board either as CEO or Chairmen and were also members of the audit committee.

The Executive Director of Linear who was also its founder issued a public statement in 2009 that it had been awarded RM1.66 billion contract by a Seychelles-based corporation, Global Investment Group Inc (GIG) to build a district cooling system for a project known as the "King Dome" project in Malaysia. The value of the contract was said to be worth US\$5 billion. Linear did not have the capacity to carry out a project of such magnitude but the Board did not question the announcement by the executive director. It was subsequently discovered by the special auditor appointed to undertake an independent probe into Linear's affairs that its financial statements from 1999 to 2008 were overstated as Linear's announcements of sales of solar energy panels and cooling tower parts to foreign corporations could not be proven and there was also no proof of the King Dome project. The Executive Director who had been instrumental in the purported projects had transferred RM36 million to Linear's Prime Savings & Trust accounts in Sweden without prior approval from the Board purportedly as a guarantee for performance to facilitate the King Dome project (Tee 2011). Linear is now placed in the Bursa Malaysia's PN17 list which is for corporations facing liquidity problems. The directors of Linear, including INEDs did not inquire into the details of the project and did not form a risk committee to assess if Linear was over-exposed when undertaking the project although there were warnings from analysts that there was a lack of transparency in the manner in which the project was announced.

The failure of the audit committee to introduce strong internal controls resulted in losses to Transmile Group Berhad (Transmile) where the founder Gan Boon Aun, remained a dominant player on the Board even after Transmile was listed in 1997. Transmile was an investment-corporation which had subsidiaries involved in the provision of air transportation services. In 2005, Transmile's auditors were unable to obtain the supporting documents from the management to satisfy itself as to the fairness of the trade receivables and related sales to several

corporations. Investigations revealed that there were no documents to support payments of RM341 million made for the purported purchase of property, plant and equipment from Transmile. Furthermore, the investigation revealed that CEN Worldwide Sdn Bhd (CEN) which was owned by Gan's nephew continued to be given credit although it owed Transmile RM103 million in unpaid debts (Rahman and Salim, 2010; p99). Khiuddin Mohammed an executive director of CEN was also an executive director of Transmile and member of its audit committee. Gan and Khiuddin played a large role in Transmile's business transactions until the financial losses were uncovered. Transmile's losses amounted to RM530 million due to overstatements and it was subsequently delisted from Bursa. Khiuddin was recently convicted for his role in Transmile's fraudulent transactions (Nazlina, 2011). Furthermore the Board including the other audit committee members did not question Khiuddin's role on the Board of CEN and the transactions between CEN and Transmile.

Kenmark Industrial Co Ltd (Kenmark) is another recent example of a corporation where a dominant director who was also its founder was able to control the Board and management. Kenmark was established by James Hwang, a Taiwanese who together with two other Taiwanese directors owned almost 50% of shares in the corporation. In May 2010 letters of demand amounting to over RM60 million were issued to Kenmark as guarantor for loans obtained by its wholly owned subsidiaries. Hwang, Kenmark's managing director together with the other executive directors who were his relatives and friends were not contactable for a week. The INEDs who did not know of these demands were alerted only when it was highlighted by the Press. They were unable to answer questions posed by the regulators or the Press on Kenmark's status (Goh, 2010). Hwang later engineered active trading of the shares due to misleading statements in the Press and disappeared once he had divested himself of most of his shares. The INEDs admitted that Hwang held information 'close to his chest' and did not keep them informed about Kenmark's financial transactions. The INEDs attended Board meetings dominated by Hwang and his family members and friends and were unaware of the company's risky financial position. Kenmark has since been de-listed from Bursa Malaysia.

Boards should be prepared to demand more accountability or transparency from senior management and executive directors. Independent directors who should not have strong connections to the Board are ideally placed to make such demands. However the levels of power distance, collectivism and assertiveness in Malaysia make it difficult for them to challenge the founder or dominant director in these situations. In the cases mentioned above there is a strong likelihood that some of the INEDs were not independent in mind and had structural bias towards their colleagues on the Board especially in the case of

Sime where one director had served for 28 years. It is also likely that 'group think' resulted in the selection of directors who were less inclined to be suspicious of people like them. The majority of the Board of Sime, MAS and Proton comprised former civil servants or government investment agency appointees. Many members of the Board moved in similar social, work and political circles and were possibly inclined to accept the assurances of the CEO or Chairman who came from the same background, that there was no financial mismanagement in spite of red flags raised by the auditors. It is difficult for them to demand more accountability when the Chairman or CEO is a person with strong political connections which raises the issue of power distance. Many of the Board members in government linked companies are Malays and in Malay culture, criticisms and challenges against those in authority or from a higher social hierarchy are considered rude and causing loss of face is often avoided. Criticisms if any, is only tendered in mild language and often after showering the powerful person with praises (Pye, 1985). Power distance may also inhibit directors from criticising founders of the Board to whom they may owe their position. Furthermore in-group collectivism results in directors' tendency to sweep matters under the carpet as pursuing controversial issues may compromise their loyalty to their in-groups. Pye notes that there is a strong tendency to defend in-groups even in the face of overwhelming evidence that someone in that in-group has committed a wrong. This is because loyalty is highly valued.

### **Malaysian Code of Corporate Governance 2012**

The Securities Commission launched the Corporate Governance Blueprint in 2011 and indirectly addressed cultural values through proposed reforms in Malaysian Code of Corporate Governance 2012 (MCCG 2012) making it easier for directors especially INEDs to carry out their monitoring duties. The reforms are addressed below.

#### **Maintaining independence**

An important step in maintaining independence of directors has been to limit the tenure of all non-executive directors including INEDs as there appears to be a serious problem in this area in Malaysia. The UK Code of Corporate Governance 2010 has taken this step and stipulated that if NEDs serve more than nine years they should be subjected to annual re-election. The Singapore Code states that a period of nine years is appropriate tenure but leaves it to the Nomination Committee to justify if a director remains independent beyond the nine years of his or her service. Limitation of tenure will prevent structural bias in INEDs who have served for many years and while the flexibility of permitting the nomination

committee to justify employing a director beyond this period may be maintained, the MCCG 2012 has adopted the period of 9 years as the norm. There is no guarantee that limiting the tenure of directors will ensure that they are independent throughout their tenure but it may reduce instances of structural bias especially as the Code requires INEDs to be assessed annually to determine their independence.

The MCCG 2012 maintains the requirement that one third of the board should comprise INEDs but has adopted similar provisions to the Singapore Code which states that half the Board must comprise INEDs when the Chairman of the Board and the CEO is the same person or the Chairman is not an INED. This change may address the problem of powerful Chairmen or CEOs who dominate the Board and will also take into account the high level of power distance and low assertiveness in Malaysia. An increase in the number of independent directors under such conditions may result in greater assertiveness as they would be able to put forward their views as a group. This should also be implemented where the corporation's founder holds an influential position on the Board even if he or she is not CEO or Chairman as they appear to wield great influence over the Board as in the case of Linear, Kenmark and Transmile. Nevertheless this will not always ensure independent and vocal boards as half the Board of Sime comprised INEDs, but this did not prevent its financial losses. The main reason for this is due to 'group think' as almost all the members of the board moved in the same work, social and political circles. This problem should be addressed through greater board diversity.

The MCCG 2012 stipulates the need for diverse boards and the CG Blueprint 2011 recommends that more women should be appointed to the board. Spain and Norway require corporations to increase the share of female directors to 40% although there is much debate on whether a quota will achieve its purposes as corporations have been unable to meet the target or have simply propelled women to the board to fulfil the target without a comprehensive training plan to ensure that they are properly equipped to take on the role. Australian corporations have increased the number of women on boards from 8% in 2008 to 14% by April 2012 through a mentoring programme initiated by the Australian Institute of Company Directors (AICD) which identified capable women and selected leading chairmen and directors of ASX 200 companies to mentor them until they were ready to serve on the board. This is a sustainable method of appointing women directors and will ensure that the appointees provide value other than diversity to the board.

There is sufficient diversity in Malaysia due to the presence of different ethnic groups comprising Malays, Chinese, Indians, Kadazan and Ibans as well as other minority groups. The levels of power distance, in-group collectivism and assertiveness among the major ethnic groups comprising Malays

and Chinese is not very different (Lim, 1998; Sendut, Madsen and Thong, 1990) although there are lower levels of power distance and higher assertiveness among the Chinese (Abdullah, 1992). In-group collectivism is high among both these groups which creates a greater tendency for 'group think'. While Boards should comprise members of various ethnic groups in Malaysia who bring different viewpoints, the similarity of cultural values indicates that it may be an added advantage to appoint foreign directors where possible as they have different cultural values and may not be as susceptible to 'group think'. It would also be an advantage to appoint women directors who bring different perspectives to the Board and are more meticulous about certain aspects of internal controls (Adams and Ferreira, 2009) but the number of women and board members from diverse ethnic backgrounds should not be mandated. Instead the Board should be evaluated every three years to assess its effectiveness and diversity. Bursa Malaysia's Corporate Governance Disclosure Guide 2012 permits the Exchange to reject the nomination of directors if it is of the opinion that it does not enhance Board diversity. This may force corporations to examine whether they have a diverse boards or risk interference by the Exchange.

## Conclusion

The significance of this research is that it highlights that structural bias and group think which is a problem faced by capital markets in general is compounded by cultural values in Malaysia. It also highlights that due to pervasive cultural values, Malaysia directors including INEDs may not resist dominant directors and as a result may not insist on strong internal controls as this is perceived as a lack of trust. Criticisms are often perceived as personal attacks and directors who persist in criticising members of the Board especially the Chairman and CEO may find themselves isolated or even removed from the Board on the grounds that they are not good team players. There is also a natural inclination to form in-groups which may affect the independence and professionalism of some directors. INEDs are placed in a difficult position of having to act as monitors of the Board and senior management under conditions where cultural values uphold in-group collectivism and high power distance.

The MCGG 2012 has taken steps to address this problem to a certain extent by emphasising the role of INEDs, requiring the nomination committee to assess their independence annually and limiting their tenure, as well as emphasising board diversity. It attempts to drive the message that INEDs have a clear role to play which the board has to recognise even if it does not resonate with cultural values in Malaysia. While there is no guarantee that this will prevent structural bias and group think, it sends a clear message that these practices are discouraged. While it may take time to

change board practices, the provisions in the MCGG 2012 are a step in the right direction.

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