

THE APPOINTMENT PROCESS FOR INDEPENDENT DIRECTORS IN MALAYSIAN LISTED COMPANIES

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Abstract

This study examines the appointment process for independent directors in public listed companies (PLCs) in Malaysia. To this end, open-ended interviews were conducted with chairmen of nomination committees of PLCs in Malaysia in order to understand the appointment process. The results revealed that nominations may come from various sources, including from the firm's board members, CEO or owners. It was also found that the nominees are those within the personal network of the board members, CEO or owners. The main reason given was to shorten the appointment process and also because they knew the candidates personally. In terms of the selection criteria, the personal qualities of a candidate were found to be very important. In particular, the board puts emphasis on experience, expertise, professional qualifications, and reputation to identify a candidate who can commit to their tasks. However, the board does not consider race, religion, and gender as important selection criteria. Our findings reveal that it is the board that makes the final decision on the appointment or reappointment of independent directors. Based on our findings, we conclude that nominations for independent directorships mainly come from inside the firms and those nominated are within their networks. In other words, the independent directors are known or connected either to the board members, CEO or major shareholders. Hence, it would be very difficult for independent directors to perform a monitoring role as prescribed in agency theory. Rather, the independent directors are appointed to the board primarily to play a service role, consistent with resource dependency theory. The fact that firms prefer professionals with experience indicates that candidates for independent directorships are appointed because of their expertise and their service role.

Keywords: Independent Directors, Appointment Process, Personal Qualities, Nomination Committee, Malaysia

JEL codes: F34, G21 and G24

1. INTRODUCTION

Independent directors play a significant role in ensuring a strong corporate structure is in place in a firm. Independent directors are very important in corporate governance because they bring an independent perspective to the firm. In fact, the issue of independent directors is addressed extensively in corporate governance codes, including the Malaysian Code on Corporate Governance (MCCG). The MCCG focuses in particular on providing guidance on the recommended number of independent directors on a board and the definition of independence. The demand for independent directors has increased not only in Malaysia, but worldwide because of the requirement for the establishment of audit, remuneration and nomination committees in listed firms as these sub-committees are expected to be composed mainly of independent directors. The role of the independent directors becomes more crucial when ownership

concentration is high as non-family shareholders depend on independent directors to act as a checks and balances mechanism on the activities of management. Thus one of the main issues of concern in relation to independent directors is the process of their appointment as it is associated with the extent of their independence. There is a perception that non-executive directors are seen as a 'rubber stamp' and are not, in effect, appointed to the board for monitoring purposes (Haniffa and Cooke, 2002).

It has been argued that the process of appointing independent directors is influenced by the top management (i.e. the CEO), owners and controlling shareholders of a company (Claessens et al., 1999, 2000; Lorsch and Young, 1990; Shivdasani and Yermack, 1999) and based on the 'old boy network' (Finkelstein and Hambrick, 1988; O'Neal and Thomas, 1995). As a result, the skills and abilities that a company requires may not match those possessed by the directors (Mallin, 2004).

Therefore, the appointment process should be transparent and robust so that only qualified and suitable independent directors are appointed to the board as they are expected to protect the interest of all the shareholders and stakeholders of the firm.

As the ownership of the listed firms in Malaysia is closely held (Haniffa & Hudaib, 2006) and because the owners want to have control over the firm, they typically appoint directors from among their family circle (Claessens et al., 2000; Mok et al., 1992). While generally in the West higher shareholdings by the owners mitigate the conflict of interest between owners and managers as argued by agency theory, the situation is different in Asian countries, including Malaysia. Hence, as opposed to their counterparts in the developed countries in the West, the independent directors in Malaysia carry a bigger responsibility as they have to monitor a firm's management that typically comprises either the firm's substantial shareholders themselves or those connected to the firm's substantial shareholders. Hence, carrying out the daunting task of protecting the interests of the firm's other shareholders and stakeholders requires independent directors who are truly independent.

The objective of this study is to examine the appointment process for independent directors in Malaysian listed firms. To this end, the researchers conducted open-ended interviews with chairmen or members of the nomination committee who are independent directors. Instead of focusing on corporate governance after the effect, i.e. *ex post* by, for instance, examining the effect of corporate governance mechanisms on the firm's various performance metrics, this study focuses on the process of corporate governance mechanisms before the effect, i.e. *ex ante* by examining the process of the appointment of a firm's independent directors.

The remainder of this paper is structured as follows. The next section contains a review of the relevant literature, which is then followed by the methodology section. The subsequent section presents and discusses the findings. Finally, a conclusion is provided in the last section.

2. PAST STUDIES ON THE APPOINTMENT PROCESS AND SELECTION CRITERIA FOR INDEPENDENT DIRECTORS

2.1. Corporate governance in Malaysia

Corporate governance became an issue in Malaysia following the 1997–1998 Southeast Asian financial crisis when Malaysia's capital market was severely hit. The Kuala Lumpur Stock Exchange Composite Index (KLCI) fell to 261 points in September 1998 from its height of about 1,200 points in March 1997, representing a total loss of about 80 per cent. Consequently, to strengthen the corporate governance practices of Malaysian firms, the Government of Malaysia through the Securities Commission issued the Report on Corporate Governance by the Finance Committee on Corporate Governance (FCCG) in 1999. Chapter 5 of the FCCG Report was formally adopted in 2000 and is known as the Malaysian Code on Corporate Governance

(MCCG). The MCCG was largely derived from the UK Cadbury Report (1992) and the UK Hampel Report (1998). While compliance by firms with the Code's Best Practices is voluntary, the Malaysian stock exchange, the Bursa Malaysia nevertheless requires each listed firm either to comply with or explain the reasons for departure from such best practices.

Following developments in the US, specifically the issuance of the Sarbanes-Oxley Act in 2002, as well as events in Malaysia such as the discovery in 2006 of accounting irregularities in Transmile Berhad, MCCG 2000 was revised and reissued in 2007. One of the areas covered by the revisions was the role of the nomination committee and specifically the criteria to be used when appointing a new director. Subsequently, to strengthen further the quality and reliability of audited financial statements of public interest entities (PIEs), the Securities Commission established the Audit Oversight Board (AOB) under the Securities Act in April 2010. The main role of the AOB is to regulate the auditors of PIEs in Malaysia. In so doing, the AOB is empowered to investigate the audit process and documentation of the auditors of the PIEs, and could revoke the licence of the auditors of PIEs who fail to observe the auditing standards.

Also, to reinforce further the corporate governance landscape in Malaysia, the Securities Commission issued the Blueprint on Corporate Governance in 2011. After consultation with relevant stakeholders, MCCG 2012 was issued in 2012 and focuses on strengthening board structure and composition while recognising the role of directors as active and responsible fiduciaries. In other words, directors must ensure that the firm complies with laws and ethical values. To strengthen board independence, two new measures were introduced. First, the tenure of independent directors is limited to nine years, beyond which they are re-designated as non-executive directors. If the board still wants to retain the independent director status of those who have exceeded the nine year limit, the board must justify and obtain approval from the firm's shareholders. Second, if the board chairman is not independent, the majority of the board members should be independent.

2.2. Appointment process for independent directors

One of the main issues pertaining to the independence of independent directors is the appointment process. Directors perform a pivotal role in monitoring managers and these directors are appointed to public listed companies (PLCs) by the nomination committee (Shivdasani and Yermack, 1999). Mace (1986) points out that CEOs usually have more say than other board members on the choice of candidates for appointment to the board. This is supported by Lorsch and Young (1990) who found that CEOs influence the selection of board members in PLCs. Shivdasani and Yermack (1999) also argue that directors are not usually selected by shareholders. Further, they also found that outside directors are not reappointed if they criticise the managers on their poor performance. In support of their contention of the importance of having independent directors on the board, Kaplan and

Minton (1994) reveal that companies tend to appoint a greater number of independent directors when a firm is performing poorly. The shareholders' response towards the appointment of independent directors is found to be positive (Lee et al., 1999) because independent directors are perceived to monitor top management and provide effective advice (Fama and Jensen, 1983). This is consistent with a suggestion made by Zahra and Pearce (1989) that the nomination committee should appoint more independent directors to the board because a higher ratio of independent directors helps the board to perform its role more independently in areas such as the monitoring of management. In addition, outside directors with expertise in the banking sector are more likely to be appointed during times of financial crisis because companies need advice and counsel as to how to overcome the crisis and survive in the market (Gilson, 1990).

The codes of corporate governance around the world recommend the establishment of a nomination committee to assist the board on matters pertaining to the appointment and reappointment of directors to the board (Ruigrok et al., 2006; Securities Commission, 2012). The nomination committee is expected to improve the effectiveness of the board by managing the board composition so that the board is balanced, which is achieved by bringing in more independent directors and appointing well-qualified members to the board (Ruigrok et al., 2006). Also, the committee must ensure that the board members whom they nominate have all the necessary skills and do not possess any business relationship with the company (Ruigrok et al., 2006; Zahra and Pearce, 1989). Jackson et al. (2003) explain that the nomination committee should not appoint independent directors by simply following a recommendation from the CEO or chairman of the board. Rather, they suggest that firms should have a formal process of appointment. Alternatively, firms could employ an executive search firm to identify suitable candidates because they have a big pool of potential candidates for executive and non-executive directorships (Korn et al., 2003). Hence, it is very important that the board has a clear policy on the appointment of independent directors to enable the nomination committee to identify and appoint board members with the required expertise (Siladi, 2006). In addition, to ensure the right people are appointed, the board should adhere to a set of selection criteria rather than make appointments based on a recommendation from top management (Jackson et al., 2003; Siladi, 2006).

Jackson et al. (2003) explain that the nomination committee should not appoint the independent directors simply by the recommendation of the CEO or chairman of the board. Rather, they suggest that firms to have a formal process of appointment rather than solely following top management's recommendation. Alternatively, firms could employ an executive search firm to identify suitable candidates because they have a big pool of candidates for potential executive and non-executive directors (Korn et al., 2003). Ideally, the nomination committee must report directly to shareholders in the annual general

meeting to ensure its independence (Ruigrok et al., 2006). However, in the East Asian region where Malaysia is located, Claessens et al. (2000) reveal that two-thirds of the companies are family owned; hence family owners inevitably have a huge influence on the selection of the board members. In fact, Claessens et al. (1999; 2000) found that institutional investors and the firm's majority shareholders exert a strong influence on the nomination and selection of the board of directors in firms in East Asian countries. Moreover, Abdullah (2013) notes the strong influence of family owners in the appointment of directors: he found that on average there are two directors who are family members on the boards of family-owned firms in Malaysia. The above findings suggest that the appointment process of independent directors in Malaysian and in East Asian companies is very much influenced by the major shareholders, which could limit the ability of the independent directors to carry out their duties objectively and effectively.

2.3. Selection criteria for independent directors

To ensure that the right people are appointed, the boards should follow a set of selection criteria for the appointment of new independent directors rather than make appointments based on a recommendation from top management (Jackson et al., 2003; Siladi, 2006). Further, they should appoint independent directors from a broad range of professional backgrounds relevant to the operations of the company (Abdullah, 2013; Pease et al., 1993). To this end, the nomination committee should consider relevant personal qualities during the selection process for new directors, including integrity, conceptual skills, business sense, experience and a sense of humour (McCabe and Nowak, 2008). In addition, the Securities Commission (2012), Pease et al. (1993), and McCabe and Nowak (2008) state that when selecting independent directors, the nomination committee should focus on the candidate's commitment, competencies, performance and contribution to the board. A board that is balanced in terms of composition and skills is expected to be effective because individual directors may have specialised skills accumulated through their professional experience (Francis, 1997). Hence, each independent director complements the expertise and knowledge of the other directors and management (McCabe and Nowak, 2008).

In the East Asian region to which Malaysia belongs, Claessens et al. (2000) reveal that two-thirds of the companies are family owned; hence, family owners inevitably have a huge influence on the selection of board members. In fact, Claessens et al. (1999; 2000) have found that institutional investors and the firm's majority shareholders have a strong influence on selecting and nominating the board of directors in firms in East Asian countries. In fact,

Abdul Rahman (2007) interviewed eight directors of listed firms in Malaysia to gauge their perception of the independent directors who were appointed to the board of directors. The findings from the interviews reveal that the appointment of

independent directors is based on their independence, experience, knowledge about the firm, and their contacts. The importance of contacts or networks with specific bodies, especially government agencies, is the main reason former top government servants are usually appointed to the board as independent directors in Malaysian firms. In fact, the existence of a relationship or *guanxi* is very important in businesses run by the Chinese who control business in Malaysia. The finding by Abdul Rahman (2007) that experience is also important is consistent with McCabe and Nowak (2008) who state that directors with industry backgrounds or expert knowledge in related fields have a competitive advantage. In another study, Abdullah (2013) found that the majority (57 per cent) of independent directors in listed firms in Malaysia are professionals with a specialisation in accounting, law, medicine, engineering, or academia. He also found that top-level ex-government servants made up about one-fifth (21 per cent) of the independent director population. Abdullah (2013) highlights that there is a preference to hire professionals and ex-government employees in order to leverage their professional advice, expertise and networks. These findings support those of both Abdul Rahman (2007) and McCabe and Nowak (2008) on the importance of experience and contacts.

3. METHODOLOGY

3.1. Sample and data

The population of this study comprised all PLCs listed on Bursa Malaysia as at 31 December 2013 after excluding PN4 and PN17 companies, i.e. companies which were facing financial difficulties, resulting in a sample of 730 companies. The chairmen of the nomination committees of these firms were selected for interview because they are involved directly in identifying and nominating new independent directors and annually evaluating the performance of their firms' independent directors. A qualitative research design using face-to-face open-ended interviews was used to collect the data because it enabled the researchers to understand the views of these participants regarding the process of appointment of independent directors and any issues of concern during the appointment process as they are personally involved in that process (Ticehurst and Veal, 1999). Further, the questions posed could be modified or clarified during the interview (Sekaran, 2000) and detailed and richer information could be obtained (Yin, 1994).

Letters to invite participation were sent to the nomination committee chairmen of the 730 companies using the company's address as stated in their annual report. To manage the interviews more systematically, the letters were sent out in several batches. The first batch of interview requests was sent to the top hundred companies based on their market capitalisation. The subsequent batches were sent according to sector as defined by Bursa Malaysia, starting with consumer products followed by industrial products, mining, plantation, property, technology, trade, and finally, the services sector. To

increase the probability of participation, follow-up contact was made with the companies through phone calls, emails or direct visits to the companies located in Kuala Lumpur, Malaysia

In total, 21 respondents agreed to participate in this study, out of which 20 agreed to have a face-to-face interview. One participant provided his response to the interview questions via email. Interviews were conducted based on the time and venue preferred by each of the respondents. Eighteen interviews were recorded using a recording device and the remaining two were manually recorded through note-taking because the participants did not allow their response to be recorded. The first interview was conducted on 13 November 2013 and the last interview was conducted on 25 September 2014. The email of the participant who responded to the interview questions electronically was received on 22 September 2014.

On average, the interview lasted about 1 hour and 10 minutes with the shortest interview taking 40 minutes and the longest taking 2 hours. The transcription was done immediately after each interview was completed. Each transcription was cross-checked by other researchers to ensure accuracy. After the transcription process was completed, the data was coded using key themes in line with the research questions and this coding was cross-checked by other researchers. Any differences in the classification of the themes among researchers were rechecked and the classifications amended if needed to ensure consistency.

4. RESULTS AND DISCUSSION

The 21 participants who were interviewed came from a range of sectors: finance (1), industrial products (7), trading services (5), consumer products (3), construction (2), property (2), and plantation (1). The participants' average age was 60.33 years, their average tenure on the board was 6.34 years and on average they held 2.43 directorships simultaneously at the time of the interview. Eight participants held either national or state honorific titles, representing about 48 per cent of the total participants. Further, 18 were chairmen of the nomination committee and three were members of the nomination committee. All the participants were independent directors and all were male. Hence, these findings indicate that directors in PLCs in Malaysia who hold an important portfolio (i.e. as nomination committee chairman) are generally 'male and old', or 'male and stale', as in the case of UK firms (Garatt, 2005). Table 1 displays the profile of the participants. After coding the transcripts, four themes were constructed, namely personal characteristics, source of the candidate, vetting, and final decision on the appointment. Table 2 presents a summary of the four themes that emerged from the interviews and the findings about the appointment process for independent directors. The following subsections discuss the codes that fall under each major theme.

Table 1. Profile of the Participants

Ref.	Date of interview	Sector	Honorific title	Age (Years)	Tenure (Years)	Number of directorships	Position on NC	Field of expertise (as stated in the firm's annual reports)
C1	13/11/2013	Finance	Datuk	67	7	8	Chairman	Law
C2	19/11/2013	Industrial products	n.a.	41	1	3	Chairman	Chartered secretary
C3	22/11/2013	Trading services	Datuk	58	7 months	1	Chairman	Civil engineering
C4	22/11/2013	Trading services	n.a.	74	11	1	Chairman	Accounting and auditing
C5	27/11/2013	Industrial products	n.a.	60	10	2	Chairman	Printing ink and printing businesses
C6	28/11/2013	Industrial products	n.a.	63	5	1	Chairman	Automotive/industrial supplies business
C7	28/11/2013	Consumer products	Dato'	62	4	5	Chairman	Investment banking
C8	29/11/2013	Construction	Dato'	54	2	3	Chairman	Management
C9	29/11/2013	Industrial products	n.a.	55	5	1	Chairman	Accounting and auditing
C10	16/12/2013	Industrial products	Dato'	52	13	2	Member	Law
C11	15/01/2014	Property	n.a.	57	7	1	Chairman	Accountant and auditing
C12	22/01/2014	Property	Dato'	68	4	2	Chairman	Engineering
C13	20/02/2014	Plantation	Tan Sri	70	8	4	Chairman	Accounting and auditing
C14	28/02/2014	Trading services	n.a.	66	7	2	Chairman	Real estate
C15	28/02/2014	Construction	Dato'	73	11	3	Chairman	Law
C16	07/03/2014	Consumer products	n.a.	55	5	2	Chairman	Accounting and auditing
C17	07/03/2014	Industrial products	n.a.	55	11	2	Chairman	Accounting and auditing
C18	25/03/2014	Industrial products	n.a.	70	9	2	Chairman	Banking
C19	10/09/2014	Consumer products	n.a.	61	6	3	Chairman	Banking and telecommunication
C20	12/09/2014	Trading services	n.a.	46	8 months	2	Chairman	Legal
C21	25/09/2014	Trading services	n.a.	60	6	1	Member	Finance

Note: The titles Datuk and Dato' are usually awarded by the respective state's rulers or the Head of State, while that of Tan Sri is awarded by the King.

Table 2. Data Matrix Analysis of Open-ended Interviews

Ref.	Themes	C1	C2	C3	C4	C5	C6	C7	C8	C9	C10	C11	C12	C13	C14	C15	C16	C17	C18	C19	C20	C21
1	Personal qualities:																					
	Experience	√	x	√	√	√	x	√	√	√	√	x	√	√	√	√	x	√	√	√	√	√
	Expertise	√	x	x	√	x	√	x	√	x	x	√	x	√	x	√	√	√	x	x	x	√
	Professional qualifications	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	x	√	√	√	√	√
	Integrity	√	√	x	√	√	√	√	x	√	√	x	√	√	√	x	x	√	x	√	√	√
	Reputation	√	x	√	√	x	x	x	√	x	x	x	x	x	√	x	x	√	x	√	x	√
	Number of directorships	√	√	x	√	√	√	√	x	x	√	x	√	√	x	x	√	x	√	x	√	x
	Age	x	x	x	x	√	x	x	x	x	x	x	√	√	x	x	x	√	x	√	x	x
	Race	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
	Gender	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
	Religion	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
2	Source of candidates:																					
	From BOD members	x	√	√	x	x	√	√	√	x	√	√	√	x	x	√	√	x	√	√	√	√
	From controlling shareholders	√	x	√	√	x	x	√	x	x	x	x	√	√	x	x	√	x	√	x	√	x
	From CEO	x	x	√	x	x	x	x	x	√	x	√	√	x	√	x	x	x	√	x	√	x
	Advertisement or recruitment agency	x	√	x	x	√	x	√	x	x	x	√	x	√	x	x	x	x	√	x	x	x
3	Verifying	x	√	√	x	x	√	√	√	x	√	√	√	√	√	√	√	√	√	√	√	√
4	Final decision on the appointment	B	B	B	MS	B	B	B	MS	B	B	B	B	B	B	MS	B	B	B	B	B	MS

Notes: C = Company; √ = Yes; X = No; B = Board; MS = Major Shareholder.

4.1. Personal characteristics

The personal characteristics of a candidate are very important as they reflect their ability to contribute to the board (MCCG, 2012; McCabe and Nowak, 2008; Pease et al. 1993). In fact, a balanced board means that the members are supposed to be able to complement each other and to support management. The participants mentioned that, as business is becoming very competitive and more rules and regulations are being introduced, they have to get the right people on the board. Nowadays, many qualified people are available so the nomination committee should be able to appoint the right person for the tasks that lie ahead. If the independent directors are not able to contribute meaningfully, their presence will not help the board to discharge its duties effectively. Two participants remarked that:

In my view, qualifications are very important and currently, you don't have a shortage of quality people. (C1)

If the independent directors just sit on the board only, then in my view these are the people who just waste time; they agreed to take on the responsibility, but they fail to contribute. (C8)

Hence, appointing a person with the right personal qualities is very important and the views expressed are consistent with the MCCG, which states that the board's composition should be balanced so that the board as a whole can function effectively. Further, a balanced board will improve the quality of the board's decisions and more importantly avoid the risk of 'groupthink' (Janis, 1972).

4.1.1 Experience

Our analysis revealed that experience is the most important personal characteristic that the board considers when assessing a candidate for an independent director post. As shown in Table 2 17 out of 21 participants (80 per cent) considered the previous experience of the candidate as very important. This evidence is consistent with the argument of, for example, Zahra and Pearce (1989) and Ruigrok et al. (2006) that independent directors must have relevant experience. According to McCabe and Nowak (2008), independent directors who have experience related to a company business can add more value to a company by giving more input during board meetings. As today's business environment is becoming more competitive, a wide range of experience among board members can contribute towards improving board performance (McCabe and Nowak, 2008). In this regard, four participants commented as follows:

We, as independent directors, will talk to candidates about their business experience and how they can take the company to the next level. We talk to them personally. (C5)

I think you need someone who has some experience of working in a corporate sector because then you are familiar with the company you serve as a board member. It is not wise to appoint someone who does not have corporate experience to the board. Independent directors should be familiar with the business, i.e. how it works, its business-related matters and financial matters. (C8)

In general, the experience of the candidate is more important. One of our independent directors has been sent out by Malaysia's government to different countries such as Myanmar and Austria at different times to deal with export business. So he often gives input in the areas of export business because of his experience in that regard. (C15)

Sometimes, we appoint independent directors directly, if we see the person has commendable professional experience. This makes the appointment process faster and we can save time. (C21)

Almost all the participants remarked that business experience is the most significant selection criterion in the decision to appoint an independent director. Independent directors are required to monitor top management and provide advice to improve the performance of a company, as argued in agency theory (e.g. Beasley, 1996; Fama, 1980) and resource dependency theory (e.g. Hillman et al., 2000; Palmer and Barber, 2001). In addition, one chairman said:

As I said earlier, it is more about a candidate's experience. If the person holds a directorship in a few companies and then he has experience in particular areas. So he will give a lot of input to the company, if appointed. (C19)

If the person does not possess the relevant business experience, then their appointment may not be effective (McCabe and Nowak, 2008; Ruigrok et al., 2006; Zahra and Pearce, 1989). More importantly, it seems that directors with vast experience can add value to a firm through the new perspectives and input that they bring to the board, which is consistent with resource dependency theory that argues that directors are appointed to the board to serve as a window on the outside world (Goodstein et al., 1994).

4.1.2 Expertise

That directors have relevant sector backgrounds coupled with relevant knowledge is vital in a competitive business environment (Francis, 1997; Siladi, 2006). Further, Daily et al. (2003) mention that it is very important for independent directors to have the relevant expertise and the necessary skills to execute their job effectively. Participants in this study seem to agree with these arguments, whereby 10 out of 21 participants (47 per cent) remarked that expertise is an important selection criterion for an independent director. They believe independent directors should have expertise in a particular area to help a company to enhance its business performance. Four participants remarked that:

I think independent directors all have a certain amount of significance but you must have certain expertise. (C13)

The board performs an oversight function, and to do that you must have the right expertise among the board members. For example, if a company is engaged in the plantation business, then you must have board members whose expertise is in the plantation sector. (C16)

No matter the type of business the company is in, you just need to have business expertise, not necessarily experience in the core business of the company, because that is the job of the management. (C15)

I have worked with international banking corporations a long time, dealing with exports, imports, and other things. So they invited me to join this company because of my expertise in international banking. (C17)

From the participants' comments above, it appears that the board desires a candidate's expertise in a particular area. The findings are consistent with resource dependency theory where directors serve as a source of advice and direction for the CEO (Daily et al., 2003). The findings are also consistent with the argument put forward by Ruigrok et al. (2006) who state that independent directors should be experts so they can contribute ideas to improve the board's decisions. Similarly, Abdullah (2013) points out that most independent directors are appointed because of their expertise. Therefore, business expertise is a significant selection criterion in the appointment of independent directors.

4.1.3 Professional qualifications

Boards are encouraged to recruit members from a wide range of professional backgrounds relevant to the industrial and marketing environment of the organisation (Kamardin and Haron, 2011; Pease and McMillan, 1993). Consistent with this viewpoint, 20 participants (i.e. 95 per cent) agreed that they looked into the professional backgrounds of candidates. They stated that a professional qualification is an essential selection criterion for new independent directors. Below are some of their views:

I was told that my name was an automatic choice as a board member for this company after they looked at my professional qualifications. (C3)

When we receive an application for a director's position, we will appoint someone to vet their qualifications. For example, for accountants, we appoint a professional accountant to evaluate their qualifications and after the evaluation, if we find that the person does not have the qualifications, we cannot employ him. (C4)

You own the company but you need certain professionals to be on your board.... They can add value to the board and company. (C5)

An audit committee chairman must have a good accounting background, and be a member of the Malaysian Institute of Accountants with at least seven years of experience in finance because you do not want people who do not know the balance sheet. (C5)

We need professionals on the board as independent directors; thus, the nomination committee can look for people like retired auditors, accountants or lawyers. (C7)

In a board meeting, if you know financial reporting standards and if you are a senior accountant and serving the board as an independent director, the CFO has to be very careful about what he presents in the meeting. (C7).

This is consistent with the findings documented by Abdullah (2013) where he found that the majority of independent directors are qualified professionals. One of the main reasons for choosing such candidates is that the firm can benefit from their professional advice and expertise. Consequently, it may be concluded that their advice and input are more important than their ability to

monitor management. Hence, resource dependency theory appears to be more dominant than agency theory in explaining the role of independent directors.

4.1.4 Integrity

Integrity is a very important quality that a director should possess as the job involves trust. Clarke (1998) and Kakabadse et al. (2001) stress that in order to play the corporate governance role effectively, an independent director should have a high degree of integrity. Similarly, Charan (1998) and Lel and Miller (2014) also emphasise that intellectual honesty and integrity are a prerequisite for effective independent directors. Additionally, Lipman (2008) points out that to align with shareholders' expectations, independent directors are supposed to exercise due diligence and care, and to act with integrity and honesty. The evidence of this study supports this contention as 15 out of 21 participants (71 per cent) mentioned that the integrity of the candidate is very important when evaluating his or her suitability. Some participants commented:

Integrity is very important. If an individual does not have integrity and dignity, what else does he have? (C4)

The most important thing is whether he or she has been involved in any unethical case or has committed any offences. He or she must be a person with integrity, outspoken and continuously in communication with the management from the lower level to the higher level. (C7)

When we appoint a new director, we make sure that he is independent with respect to all the requirements of Bursa Malaysia. Besides that, their time, integrity and honesty are very important. (C9)

Integrity is number one. If you do not have it, you cannot be on the board because your role is to represent all shareholders. (C13)

We need to look into his background to see whether he has any bad record and to make sure the person has a good background and image. (C19)

The above comments indicate that the past records of a candidate are used to determine the integrity of the candidate. In fact, one participant said that integrity is the most important criterion as the independent director acts on behalf of the firm's shareholders. Nevertheless, the independent directors should also represent the interests of all the firm's stakeholders so that any decisions made by the board will not have any adverse effects on them, such as on the environment.

4.1.5 Reputation

From the perspective of resource dependency theory, a director's good reputation and network could link the firm to external resources (Pfeffer and Salancik, 1978). Similarly, Lel and Miller (2014) highlight that a director's reputation enables him or her to undertake the monitoring role effectively. The firm could also leverage the reputation of the independent directors to build its image and brand. However, in this study, only eight out of 21

participants (38 per cent) considered the reputation of the candidates when selecting independent directors for their company. Three participants remarked that:

The person must be of some standing in the business community, have some experience in certain industries and most importantly a good reputational background. Background goes with reputation. This is because a good background will give a good reputation. So we consider his experience, reputation and level of education and all of them play a very important role in the selection of an independent director. (C4)

We look into our network first because we already know about their background and reputation... and that they are somebody whom you can trust. (C8)

The reputation of the candidate is necessary for business networking. (C19)

Reputation is important as business in Malaysia is dominated by the Chinese who value *guanxi* (relationship or connection) when doing business. Further, as regards business values, the Chinese place greater importance on 'knowing who' rather than 'knowing how' (Backman, 1999). Holding either state or national honorific titles is also associated with a person's reputation. In fact, eight participants in this study hold various state or national honorific titles themselves. In addition, Matolcsy et al. (2004) suggest that holding multiple directorships increases the reputation of individuals. This reputation helps them to network and is helpful in acquiring new, valuable business contacts. The data in Table 1 shows the link between having honorific titles and multiple directorships. The eight who hold honorific titles collectively hold 28 directorships (3.5 directorships on average) compared to the 13 without honorific titles who hold only 23 directorships in total (1.8 directorships on average). Thus, on average, directors with honorific titles hold twice as many directorships as directors without honorific titles. This evidence suggests, in the Malaysian context, that having honorific titles is associated with one's reputation.

4.1.6 Commitment

One constraint that could prevent a new director from giving commitment to a company is that of time. Harris and Shimizu (2004) argue that holding multiple directorships could signal that independent directors do not have sufficient time to prepare for board meetings, which could limit their ability to be involved actively in discussions. This underscores the significance of having time to commit to the task (Annuar, 2014). In addition, if directors are extremely busy, there is the possibility that they may not be able to attend board meetings (Annuar, 2014). McCabe and Nowak (2008) also raise the same concern and state that independent directors should first consider their availability before committing to the job. In this study, 12 out of 21 participants (57 per cent) stated that they consider the number of directorships of a candidate. Three participants said:

A director of a public listed company may have two or three directorships. I think this number is okay. You need to read all the papers and go through all of them and provide feedback.

Maybe more than that is not possible. As for myself, I am also busy with my own business so for me three would be enough. (C12)

The Bursa's new rule is that you cannot hold more than five directorships in listed companies. So, if the five companies are big, you will have more than 12 board meetings a year and, in addition, you will need to be involved in subsidiaries, board sub-committees, audit and other activities in a year so it will add up to more than 20 meetings a year. So this is quite a lot. (C7)

If an independent director has more than six or seven directorships, how will they manage their time? They need to attend meetings five to six times annually at least once every three months. (C5)

The evidence in this study is similar to that in Latif et al. (2013) who point out that multiple directorships are common in Malaysia and 90 per cent of Malaysian directors have one to three directorships. Likewise, Abdullah (2013) points out that on average one independent director in Malaysia holds two directorships in other PLCs. One participant remarked that:

The nomination committee will talk to the nominees before the appointment to make sure that the individual is committed to serve and not just to come and warm the chair. This is because as a board member you are expected to exercise oversight functions and be up to date and familiar with the company's activities so that you can contribute during meetings. (C13)

Being able to give their commitment to board meetings is very important as board meetings discuss a wide range of issues that pertain to the firm, including governance and strategic issues. In order for the independent directors to be able to contribute effectively, they have to do homework prior to meetings, which includes going through the materials and doing some research on the issues to be discussed. If they hold many directorships, they will not be able to devote enough time to this task (Matolcsy et al., 2004), which defeats the purpose of their appointment. As independent directors, they have to perform service and monitoring roles, which requires them to be prepared when they attend meetings.

4.1.7 Age, gender and ethnicity

Age is another factor, but it was raised by only five participants. Age is an important consideration in preventing the board from being dominated by the older generation; the term used by Garatt (2005) is 'stale'. However, generally, the participants in this study indicated that their companies prefer directors aged 50 years or more as they have more experience. Three participants remarked that:

I look at the capability of the person. If that person is young and cannot contribute then he disappoints me. (C1)

Our board prefers middle-aged people as independent directors, i.e. between 40 and 50 years old. These people have the experience, so they can contribute. That is why our board members are generally a bit older. (C17)

For me it depends on the person. I mean some people who are already 70 years old but they can still work and contribute a lot to the

company as a board member.... For me, you need look at the person and his or her contribution instead of looking at age only. (C8)

Based on the responses above, capability rather than age seems to be very important when considering a candidate for an independent director position. Hence, a young but capable person could be appointed not only as an independent director, but also as a chairman. Other participants remarked that:

I will never agree to the fact that age plays an important role in determining the ability of a director of a company. For me, we can accept a chairman who is even younger than us as long as he can demonstrate the capabilities that he has. (C3)

I will look at the age. Age is also a factor. If one is 40 years old and another is 60 years old or more, then, normally I will go for the younger one. (C5)

I prefer diversity in age diversity in terms of age group. You don't want the board to consist of too many old people, rather we prefer younger people who have the experience. (C13)

Yes age is important. Because sometimes you know if you are too young you might not have enough experience in today's environment and if you are too old and you are a CEO or manager or director you may not have enough strength to complete your task. (C12)

Generally, even though age seems to be an important element, it is not the determining factor, a key criterion. The evidence in this study shows that a person's experience and capability are the two most important criteria that the participants look for. This is because older candidates have more experience compared to the young. Hence, the evidence of this study is consistent with that of other researchers who found that the majority of independent directors in Malaysia are in their late 50s. In fact, Latif et al. (2013) found that the average age of independent directors is 56. Though they argue that if the majority of board members are too old as their performance may be reduced because they cannot put more effort into the company, our evidence seems to rebut their contention (Latif et al., 2013). However, one participant prefers young directors. The main reason for preferring young independent directors, perhaps, lies in the premise that they are risk takers and their decision-making process is faster relative to older directors (Koufopoulos et al., 2008; Latif et al., 2013).

As regards the important issue of gender, in 2011, the Government of Malaysia issued a policy which requires each listed firm to have at least 30 per cent of its board seats occupied by women. This policy reflects the perceived importance of women to the effectiveness of the board as found in prior studies in other jurisdictions (Beckmann and Menkhoff, 2008; Eckel and Grossman, 2008; Fehr-Duda, 2006; Watson and McNaughton, 2007). Another important issue is that of ethnicity as it has been argued that having people from various cultures on a board leads to high-quality and more feasible ideas (McLeod et al., 1996). In addition, directors from minority groups encourage diversity in the board decision-making process (Westphal and Milton, 2000). The participants in this study generally held the view that if a woman had the

necessary experience, the nomination committee would recommend her name to the board. Some participants remarked that:

We don't have any problem with gender, race or religion... in fact we have Muslims, Buddhists... it is not an issue. (C14)

There are a few criteria, for example, 30 per cent of directors should be female... but you must also look at whether the lady can do the work or not to contribute. (C21)

I have no preference as long as the person can perform the job. But in the case of females, they become less active when they are pregnant. But if we see that a female is qualified and can perform the job, it should not be an issue. (C10)

Race is less of a consideration... I think all companies should be sensitive to having a board which reflects the multi-racial nature of the country. (C3)

Thus, gender and ethnicity are not the main considerations when choosing an independent director in PLCs in Malaysia. Our findings are therefore consistent with those of Abdulah and Ku Ismail (2013) who provide mixed evidence for the influence of gender and ethnic diversity on firm performance. Rather, the experience of the individual is the main desirable criterion in selecting independent directors (Daily et al., 2003; Kamardin and Haron, 2011; Tinggi et al., 2014).

4.2. SOURCES OF INDEPENDENT DIRECTORS

4.2.1. Proposal from the board of directors

The majority of the participants, i.e. 14 out of 21 (66 per cent), mentioned that a proposal for the appointment of an independent director could come from any board member. This evidence signifies the importance of knowing the candidate personally or someone in their circle knowing the candidate personally (Lipman, 2008; Yermack, 2004). However, this practice reflects the tendency of appointing 'people like us' (Grady, 1999) because the nominees are usually within their own business or professional network or *guanxi*. This point is illustrated by the comments from four participants:

To appoint new independent directors, we (board members) probably need a few names, so anybody can put forward names and we (nomination committee) will review the names, their responsibilities, related skills, and how they can add value to the company. (C8)

We prefer someone within our own network and who is qualified. In my view, it is easier to hire independent directors from our own network, but the most important thing is that the person must be qualified. (C21)

We usually ask our friends if they know anybody who would be interested. But, at the end of the day, we look at the qualifications. (C11)

If the board prefers someone, they can always nominate and submit the name to the nomination committee. We will evaluate the strengths of the particular person in terms of his expertise and how he can enhance the company. (C10)

Based on the above comments, it appears that the nomination committee plays a very important

role in the nomination process of a new independent director as the committee evaluates the suitability of the candidate for the position.

4.2.2. Proposal from the controlling shareholders

Nine out of 21 participants (42 per cent) mentioned that they received proposals from controlling shareholders. They argued that the controlling shareholders had a right to nominate because they had invested a huge amount of their money in the company. Some participants mentioned that:

In [company name], the majority shares are held by [institutional shareholders] and they can nominate whomever they want to become a director because they want to ensure their money is secure. (C13)

Our majority shareholder [name of the shareholder] normally proposes a person who is experienced in the banking industry. (C4)

...if it is a family-owned business, the majority shareholders are expected to have the interest of the company at heart more than any other person. They bring in independent directors so that they can help them with ideas. (C13)

It seems that the participants view nomination by the firm's majority shareholders as a common and acceptable practice even though this practice could affect the independence of the independent directors. However, one participant cautioned that this does not mean they ignore minority shareholders:

I was made to understand that in good governance, in general, a company needs a minimum percentage of independent directors to balance the interests of all shareholders and also to keep an eye on the minority shareholders to protect their rights. (C3)

Since the role of independent directors is to monitor the company's management, issues may arise as regards their independence as they may work in favour of the controlling shareholders (Amran and Ahmad, 2010; Claessens et al., 2000; Ruigrok et al., 2006). Nevertheless, if the role of independent directors is to provide a service and advice to management, the issue of independence may not be critical.

4.2.3. Proposal from the CEO

A proposal for a new independent director from the CEO is another common practice in Malaysian listed firms, which is consistent with the evidence provided by Shivdasani and Yermack (1999). The results from the interviews revealed that seven out of 21 participants (33 per cent) mentioned that they had received names from the CEO. Three participants illustrated this by stating that:

The CEO may propose names of candidates and the nomination committee will interview them. (C3)

The CEO or major shareholders play a role where they would probably look for some independent directors. (C18)

Sometimes we receive a name from the CEO or top management. However, as a nomination committee we need to check the person has got

the qualifications, experience, and exposure and that he is a suitable person. (C20)

The main reason for this practice is attributed to the fact that top management knows best about the internal operations of the business and know what types of expertise are required of outsiders. In fact, CEOs know the CEOs of other listed companies who can serve as independent directors. However, in this case, independent directors who are friends of the firm's CEO might not be able to perform their duties objectively as they would be indebted to the firm's CEO. Hence, they might not want to 'rock the boat' if anything goes wrong in the company.

4.2.4. Advertisement or recruitment agency

Only a small number of participants, i.e. six out of 21 (28 per cent), mentioned that they used advertisements. Participants are of the opinion that advertising and headhunting are time consuming. Four participants remarked that:

We do not advertise in newspapers or via any other sources because it is time consuming. The reason is that once an advertisement appears in the public media, then many people may get involved. One of them could be a politician.... If someone gets the position through political connections, then it can be problematic to run the board effectively. (C21)

...normally during the appointment process, we sometimes go for headhunting. Most of the time we look for independent directors within our business circle who are interested in becoming an independent director in our company. (C5)

We do advertise when there is a vacancy for an executive director's position. But we don't advertise for an independent director position. (C11)

We sometimes receive names from a search firm. We tell them our requirements so they can directly search for candidates. For instance, you need the search firm to find out whether the candidate is bankrupt or not, or whether they have credit issues and so on. (C7)

It does appear that nominating people within the network of the directors or the CEO makes the appointment process faster as they know the candidates, rather than using a recruitment agency or advertisement where the process takes a long time to complete. Hence, personal connection plays a very important role in identifying nominees for independent director positions.

4.3. Vetting the potential candidates

Vetting by the nomination committee is a very important process in order to ensure that only qualified individuals are appointed as a firm's independent directors. The most important objective is to ensure only suitable persons are appointed who will contribute to the board (Petra, 2005; Ruigrok et al., 2006). In our study, 16 out of 21 participants (76 per cent) stated that they would check the background of the candidates. Four participants said:

...vetting is done to reduce the numbers and the nomination committee only brings shortlisted candidates to the board. (C2)

Basically you need to know the person. You need to check the background and the reputation of the person. If you know the person well, then it is fine. But, if the person is shoddy and their responsibilities are not discharged properly, then this is a big problem. (C8)

We do the normal background checking.... We do it in an informal way and we discuss it at nomination committee level... ..sometimes we check via phone calls... ..sometimes, the major shareholders screen the candidate's background, skills and previous employment. (C7)

In our case, we use a checklist in order to evaluate the candidates. We look at the checklist and propose the shortlisted names to the board.... Let me tell you, if you are an 80-year-old person, what is the point of having the checklist for him? (C11)

The purpose of vetting the nominees is to shortlist the candidates so that the board has to scrutinise only the shortlisted candidates very closely. This makes the job of the board easier and faster. In addition, interviews are also performed in order to get to know the candidates better, as mentioned by two participants:

It [the nomination process] usually starts with the nomination committee conducting an interview. (C2)

Normally if someone proposes any name to the nomination committee or to the board, then there will be an interview to get to know the person. (C15)

The findings of this study are similar to Nutt (1971), who mentions that the nomination committee may conduct interviews with the candidate before making their recommendations to the board. The participants mentioned that the vetting of potential candidates before conducting interviews is performed to save time and resources as then only the most qualified candidates are interviewed. During the interview, the nomination committee must be very selective so that only the right persons are appointed (Siladi, 2006). Similarly, Ruigrok et al. (2006) note that the nomination committee should be strategic in selecting potential candidates who can contribute to the board. The main objective is to appoint the right person, someone who is enthusiastic about acting as an advocate for all the shareholders of the company (Petra, 2005).

4.4. Final decision on the appointment of independent directors

In terms of the final decision on the independent director's appointment, 17 out of 21 participants (80 per cent) stated that the final decision on the appointment of a new independent director rests with the board. However, in general, the board tends to accept the recommendation from the nomination committee. In this regard, some participants stated:

In appointing independent directors, the board has the final say. (C1)

The board has the final say in appointing independent directors... ..it happens at other companies as well. However, the amount of

information that the nomination committee has is greater than that of the board because the nomination committee knows the candidate in detail. Therefore, their recommendation is very important. (C2)

As the chairman of the nomination committee, I do not make the decision alone, but rather, the whole nomination committee makes a decision on the appointment of a new independent director. Usually, the nomination committee will make a recommendation to the board, and then the board will accept it. (C18)

Basically, this is the decision of the nomination committee, consisting of myself as the chairman of the committee, the chairman of the board and another director. (C18)

Our evidence is consistent with the argument that the nomination committee knows best about the candidate (Petra, 2005; Ruigrok et al., 2006). In some circumstances, the directors employ a voting process in selecting new directors. Nevertheless, four participants (19 per cent) mentioned that the major shareholders have the final say in appointing new independent directors. Three of these participants stated that:

In our company, the major shareholders make the final decision. ...every company has a controlling shareholder, so the controlling shareholder will have a significant influence on who participates on the board. (C8)

If more than one candidate is available for the position, then the main shareholders would normally have the final say. (C4)

The major shareholders have a bigger say on the appointment of the independent directors. However, they do not indicate it explicitly, but rather we have to check with them first. (C15)

The findings of this study are similar to Claessens et al. (1999; 2000) who found that the majority shareholders have a significant influence on selecting and appointing the board of directors in East Asian countries. Since the majority shareholders have an influence on independent director appointments, the issue of independence will arise because they are appointed by a certain group of shareholders (Ruigrok et al., 2006). However, from the results of this study, it seems to be only a minority practice as a great majority of firms leave the decision on such appointments to the board without interference from the majority shareholders.

5. CONCLUSIONS

This study examined the appointment process for independent directors in Malaysian PLCs. The findings of the study generally show that the personal characteristics of the candidates are very important selection criteria. These include the person's expertise, professional qualifications, integrity and reputation. The gender or ethnicity of a candidate is not deemed to be important. It appears that firms are interested in individuals who can bring value to the board, regardless of their gender or ethnicity. The value that they bring to the firm is derived from their expertise in their respective areas. Thus, based on these findings, the main motive for appointing independent directors to the board is to add value to the firm by having these

directors fulfil service and advisory roles, which therefore is consistent with resource dependency theory.

The findings also reveal that proposals for new director appointments mainly come from three sources: the firm's board of directors, CEO and controlling shareholders. Thus, the potential directors tend to be within the circle of the directors of the board, CEO or owners who know the candidate either through their personal networks or come into contact with them via requests for recommendations from their friends. Hence, it is the 'know who' which comes first, followed by the 'know how', which is particularly predominant in *guanxi*-based business culture. Therefore, the ability of independent directors to perform their control role may be limited because they are indebted to those who have nominated and appointed them. In light of this, the service or advisory role seems to be the main role of the independent directors rather than the control role.

The results also showed that the nomination committee plays a very important role in identifying and vetting the potential candidates for independent directorships. Nevertheless, as stated above, their efforts to search for candidates are limited to their own circle. In fact, it was found that the nomination committees rarely use a third party when identifying a potential candidate. For instance, in 2009, the Minority Shareholder Watchdog Group undertook an initiative to create a pool of potential directors to which listed firms could refer when looking for independent directors. However, this pool is not used by the firms in this study when searching for new independent directors even though the individuals listed in the pool are members of various professional bodies and have a long experience in senior managerial positions (Bushon, 2010). It would seem that they are not chosen because they are not within the circle of people who make the decision on the appointment of independent directors. While it was found that the final decision on the appointment of a new independent director lies with the board itself, the final decision might be heavily influenced by the firm's CEO or majority shareholders. This is because ownership in Malaysian firms is highly concentrated and in order to control the flow of information about the firm, the owners will not want to appoint someone whom they do not know to serve on their board. Further, given that Malaysia is a high power distance nation and the majority shareholders usually appoint the chairman and the CEO, it is very likely that the other board members would agree with their recommendation as they hold the leadership positions in the firm.

The findings of this study lead to three major conclusions. First, to be appointed to a board as an independent director, one has to be expert in a particular field, a professional and, more importantly, one has to be in the circle or network of the board members, CEO or owners of the firm. Second, it seems that the Malaysian government's policy to increase women's representation on the board of listed firms to 30 per cent by 2016 is not being taken seriously by the boards in PLCs. Hence, aspiring women need to prove that they have the same capability as men in order to be appointed to the board. In other words, there is no tokenism in

the appointment of female directors. However, more importantly, they must be noticed by the directors or the CEO of a firm. Third, the boards of Malaysian firms lack diversity as they tend to choose independent directors whom they know or their friends know, suggesting that they choose directors who are like themselves or 'cut from the same cloth'. This is very similar to the picture for UK firms where there is a tendency to choose middle-aged, male directors. Hence, there is a risk of groupthink in Malaysian listed firms.

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