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"Towards an Internationally Competitive and Highly Efficient Capital Market - The Importance of Good Corporate Governance"

Keynote Address

by

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at the

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Assalamualaikum w.b.t and a very good morning to all present.

Minority shareholder activism in the Western world finds its origins in the concentration of holdings and growth in power of institutional investors over the past two decades, particularly in the U.S, manifesting itself in a new focus on managerial attention to shareholder well-being. Hence was birthed the concept of "shareholder value" which became the new standard in measuring corporate performance. Under a value based management philosophy, management's key task is to ensure that the full value potential of a company is realised. Boards are expected to assess the organisation's current and potential value on an ongoing basis and to constantly address the question of whether assets are being deployed for maximum return, and whether the business is creating or destroying value. Today for example, as a result of shareholder activism, most Fortune 1000 companies have a majority of outside directors, with committees of outside directors to establish CEO compensation packages and nominate new directors - many have dedicated investor relations departments.

In Asia over the past few years, the globalisation of national markets and the ensuing competition that this engenders as well as the increasingly important role played by foreign portfolio capital has brought to the fore the growing significance of adopting these self-same value based management principles. After all, global capital is rarely patient and liquidity will likely gravitate towards markets that possess higher standards of behaviour and performance. Coupled with the strong concentration of holdings and the current infantile stage of shareholder activism in Asia, this difference in origin essentially explains why in Asia significant corporate governance reform initiatives have tended to be state driven or "top down" affairs whilst in the more developed western economies they tend to be driven by the market. However, it must be stressed that a "top down" approach to corporate governance reform can only be meaningful and effective provided they are equally supported and internalized by all market participants.

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Ladies and Gentlemen,

Axiomatic to very the existence of competitive and efficient capital markets is their ability to attract capital, both domestic and foreign, to fund corporate development. In this context, the corporate governance reputation of the market plays a central role - the ability of markets to obtain and retain a reputation for good corporate governance is in fact perhaps almost as important as the very practice of good corporate governance by its corporate constituents. In this regard, the achievement and maintenance of a good corporate governance reputation in the market is a factor that underlies the achievement of each strategic objective in the Capital Market Masterplan. I will elaborate on this later.

In the context of individual companies, it has often been pointed out that corporate success in raising capital in the capital market hinges directly on their ability to earn a good corporate governance reputation. It is now getting increasingly trite to observe that in the Asian region, institutional investors are willing to pay a premium of more than 20% for the shares of companies that demonstrate good corporate governance. And of course not without good reason. The flip side of this is that institutional investors will punish companies perceived to practice poor corporate governance and the flight of capital experienced during the financial crisis has taught us that they will do so brutally. In our own domestic markets, the growing market intolerance for value destruction over the past few years have been reflected in substantial discounts in the share prices of a number of prominent Malaysian companies by the market in response to what the market considers to be poor governance practices of these companies. It is most likely that any future capital raised by such companies or their subsidiaries in the market will also be severely discounted by the market.

But why is this so? The answer is simply that investors inevitably price in the risk attached to the corporate governance history of a company, alongside other corporate risks. Once all the risks are priced in, the forces of supply and demand work to deliver a market price. I believe the same argument applies equally to capital markets as a whole and hence, corporate governance practices by individual companies affect the very markets in which the securities of these companies are traded.

Capital markets exist to meet the funding needs of companies through the allocation of funds from investors to issuers. In order to facilitate this transaction, price discovery, risk management and corporate governance play major roles in the market. The trend has always been that where capital markets were perceived to have weak market or regulatory infrastructure, the risks of such market weaknesses were often deemed to have carried risk management implications - the risks of which having been effectively priced into the market. Corporate governance carries a similar impact on the market - If investors feel that their investments in a particular market return poor value because of poor corporate governance treatment, such risks will equally be priced into the market. To explain this proposition in the language of welfare economics, the concept of a corporate governance reputation involves an externality - any one particular company cannot fully capture its own investment in

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reputation. Some of that investment in reputation spills over and enhances the reputation of the entire market. By implication therefore, poor quality companies in the market steal some of the value of their competitors' reputations because bad reputations spill over to the rest of the market just as good ones do.

Equally, the competitive positioning of market institutions and intermediaries - which include exchanges, professional firms and merchant banks - are strongly influenced by the corporate governance reputation of the market. By handling corporate listings, reports or exercises, such institutions and intermediaries in a sense vouch for the credibility of the securities which they handle and this places their very own reputations at risk. As repeat players in the capital market, market institutions and intermediaries have a strong incentive to ensure that they duly discharge their corporate governance obligations because they stand to lose much more than the average misbehaving company in a weak market environment.

It has also to be emphasized that poor corporate governance also carries more significant and longer term implications to the market. This is so because in markets where the prices of securities are discounted for poor corporate governance, honest companies will not be able to receive a fair value for their securities and would have an incentive to turn either to other forms of financing or to other markets that have a more conducive environment. More worrying, discounted prices will not discourage dishonest issuers from participating in the market. The flight of quality firms coupled with the proliferation of poor quality firms worsens the problem faced by investors. Investors in turn, rationally react to the lower quality of issuers by discounting still more the prices they will pay. This drives even more high quality issuers out of the market in what is an effectively brutal and endemic downward spiral. In the worst case scenario, liquidity will simply dry up as investors avoid the market.

However, the good news is that it also follows that the reverse is equally true - markets which have a reputation for good governance will enjoy a mark up in the prices of their securities, which will encourage the participation of high quality issuers, which will in turn attract liquidity - and so on. Simply put therefore, bad companies help to create bad markets, whilst high quality companies which practice good corporate governance help to create strong markets.

Ladies and gentlemen,

Regulators and capital market constituents alike carry responsibilities to be discharged in the task of developing a strong and effective regulatory framework for good corporate governance. In Malaysia, the Finance Committee Report on Corporate Governance and the Capital Market Masterplan collectively provide us with a cohesive blueprint for corporate governance reform agenda over the period of the next 10 years. Essentially, the approach prescribed has been to effect legal reform alongside the introduction of voluntary codes, facilitating investor education and training and inculcating shareholder activism. It is

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fundamentally believed that the appropriate mix between self-regulation by the market and regulatory discipline by the regulators is essential in the development of a strong and effective framework for corporate governance regulation in Malaysia.

The release of the Finance Committee Report on Corporate Governance by the High Level Finance Committee of Corporate Governance in 1999 provided the momentum for corporate governance reform which has certainly accelerated over the past two years as is evidenced in the strong commitment and positive responses from regulatory agencies and the market alike. Allow me to cite a few examples.

- As you are aware, the Malaysian Code on Corporate Governance was issued in March last year and was designed to facilitate corporate self-regulation in the area of corporate governance. The Code, establishes the principles and best practices of good governance and is consistent with international best practices in this area. While the Code is voluntary, companies wishing to depart from the Code must however state the reasons for their departure. The Kuala Lumpur Stock Exchange (KLSE) now requires such disclosures in the annual reports of listed companies beginning with companies with financial years ending from 30 June 2001 onwards.
- Measures to further promote corporate self-regulation through the training and education of directors commenced this year with the amendments to the KLSE Listing Requirements which now require directors of its listed companies to attend prescribed mandatory accreditation training programmes.
- In terms of the training and education of the investing public and other market participants, I am happy to note that organisations like the Malaysian Institute of Corporate Governance (MICG) and other professional bodies are actively supporting and complementing the work of the exchanges and regulators. They all should be given credit for being proactive in organising and participating in seminars, conferences and workshops which are intended to inculcate investor activism and awareness such as this one today. The relevant professional bodies have also begun to be proactive in this area. The Malaysian Association of The Institute of Chartered Secretaries and Administrators (MAICSA) for example, has recently contributed to this effort through the publication of their Best Practices Guide to Annual General Meetings and their Best Practices Reference Kit for Company Secretaries.
- What I find most encouraging is the general response of the market to corporate governance reforms. I think the trend over last two years reflects the increasing interest of Malaysian investors to understand their rights and responsibilities better and to participate more actively in monitoring corporate behaviour. The increased interest in corporate governance by the market is evidenced not least in the strong

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public support for training programmes such as this one today. It is most heartening to note continued strong public support for ongoing investor education programmes despite prevailing market conditions.

- In terms of the exercise of voting rights, while at this stage the general rule still seems to be that the Malaysian market prefers exit over voice, minority shareholders are increasingly becoming more proactive as has been evidenced in the strong minority opposition over a number of recent prominent corporate exercises. Legal actions being pursued by minority shareholders, albeit still few and far in between, are no longer a novelty.
- As you are aware, a Minority Shareholder Watchdog Group to encourage proactive shareholder participation in public listed companies (PLCs) has also been set up. The Watchdog Group, initiated by the largest institutional funds in the country, is intended to harness the ability of large albeit minority institutional investors to monitor and institute change where necessary in the companies they have invested in. The Watchdog Group will be licensed as an investment advisor in order to ensure its independence and is expected to be fully operational by this year. I am pleased to note that you will be hearing more about the Watchdog Group in the course of this seminar.
- Finally, the Finance Committee Report had also made extensive recommendations for the reform of laws, rules and regulations in order to strengthen the regulatory framework for public listed companies. These recommendations addressed a number of key issues, such as the need to improve the quality of corporate disclosures and the clarification of responsibilities and obligations of shareholders. A prominent issue raised in this regard was the need to enhance minority shareholder rights and redress mechanisms. A number of measures under this rubric were introduced in the recent amendments to the KLSE Listing Requirements released on 22 January 2001, and the relevant regulatory agencies are working hard to ensure the timely implementation of the remaining recommendations.

Clearly we have achieved a great deal over the last few years. And it is heartening to note that our efforts have not gone unnoticed. I am sure many of you would have read recent newspaper reports that a survey of expatriate business executives conducted by the Political and Economic Risk Consultancy (PERC) showed Malaysia in top most overall ranking for corporate governance. In a scale from zero to 10, with zero being the best grade, Malaysia came top with a score of 3. This represented a 51.6% improvement for Malaysia on a score of 6.2% achieved in the same survey last year.

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Ladies and Gentlemen,

The Capital Market Masterplan which was released earlier this year seeks to comprehensively chart the strategic positioning of the Malaysian capital market over the next 10 years. The broad vision of the Masterplan focuses on the development of a highly efficient and internationally competitive capital market, having the ability to meet the country's basic capital investment needs and which is supported by a strong and facilitative framework. Needless to say, corporate governance is a prominent feature of the Masterplan. The Masterplan is premised upon the achievement of six key objectives that relate to all the key segments of the Malaysian capital market. These are expressed in 152 recommendations, 10 of which relate directly to corporate governance. The six objectives are:

- To be the preferred fund-raising centre for Malaysian companies;
- To promote an effective investment management industry and a conducive environment for investors;
- To enhance the competitive position and efficiency of market institutions;
- To develop a strong and competitive environment for intermediation services;
- To ensure a stronger and more facilitative regulatory regime; and
- To establish Malaysia as an international Islamic capital market centre.

In the area of the corporate governance, the Capital Market Masterplan builds upon the momentum begun by the Finance Committee Report and further develops the corporate governance reform agenda in a number of key areas. In general, the full adoption of a market-based approach to regulation over the period of the Masterplan represents a clear shift on the part of the Securities Commission towards the use of competitive market disciplines and processes. The Masterplan states succinctly that this will be reflected in " ... a more active and risk-focused supervision, stronger and swifter enforcement and the use of incentive structures to promote a high level of regulatory compliance." Correspondingly, in the area of corporate governance, the Masterplan places a strong emphasis on developing the role of the active exercise of market discipline and enforcement mechanisms and this is clearly evident in the 10 corporate governance recommendations in the Masterplan. These may be briefly summarised as follows:

- To promote shareholder activism through further improving avenues for minority shareholders to exercise and enforce their rights and encouraging greater institutional investor participation in corporate governance and the promotion of shareholder value. This encompasses the raising of standards of investor protection in related party transactions, the introduction of measures such as cumulative voting, statutory derivative actions as well as the possible introduction of statutory

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civil and criminal remedies for the failure to make timely and accurate continuous disclosures to investors.

- To ensure high standards of financial reporting and the continuous disclosure of timely, relevant and accurate corporate information to the shareholder to facilitate market discipline and informed investor decision making. More specifically, this includes measures to enhance the channels of communication between company and the shareholder, enhancing corporate disclosures in annual reports and the introduction of specific shareholder value metrics to ensure that the appropriate shareholder value disclosures for corporate exercises are properly provided for.
- To further enhance the awareness of and accountability for the duties and obligations of company directors, financial controllers management and officers, and strengthening the role of auditors of PLCs; and
- To ensure the timely and effective implementation of the Finance Committee Report on Corporate Governance.

It can therefore be seen that the Masterplan brings to the fore the pivotal role played by the industry within the regulatory framework for corporate governance currently under development. In this regard, the enhancement of the frontline regulatory powers of market constituents to enforce market discipline - encompassing investors, issuers, intermediaries, market institutions and the relevant professional bodies - carries with it corresponding responsibilities to be discharged.

Companies must practice self-discipline through the adoption of principles and best practices of the Malaysian Code on Corporate Governance. Likewise, market intermediaries and institutions such as legal and accounting firms, merchant banks and stock exchanges equally carry significant responsibilities to be discharged - not least because, as I mentioned earlier, these market institutions and intermediaries in a sense vouch for the credibility of the securities in which they approve or handle and this places their very own reputations at risk. However, I would like to emphasize that shareholders as owners of the company ideally bear the ultimate responsibility for monitoring the corporate governance performance of their companies and to make considered use of their votes. The power to vote on major corporate issues is one of the most fundamental ownership rights held by shareholders of a corporation and shareholders should not neglect this duty. In particular, through proxy voting activities and shareholder activism, large institutional funds are in a prime position to act as a " watchdog" over the businesses in which they invest and must as such discharge their fiduciary obligations to make corporate management accountable.



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Ladies and Gentlemen,

Globalisation and the forces of globalised competition in the 21st century undoubtedly present us with significant challenges. The increasing importance of foreign portfolio investments coupled with the pressures brought about by large capital flows indeed make the road ahead for any capital market in the emerging world, not least our own, a daunting one. However I prefer to view these challenges as opportunities. A country that possesses a capital market that is strategically equipped with a strong and competitive regulatory and market infrastructure, coupled with a reputation for corporate governance excellence will certainly have a competitive advantage over those with weak ones. However, the development of an effective regulatory framework for corporate governance as envisaged by the Capital Market Masterplan will require both the commitment and proactive participation of the industry as much as it does the regulators. Indeed, our efforts towards building an internationally competitive and highly efficient capital market will no doubt be jeopardized if any one party fails to play its role. In this regard, while there is admittedly a long road ahead of us, I am certainly pleased with the progress that we have made thus far and I hope that the momentum in the area of corporate governance reform that we have experienced so far will continue to accelerate in the years to come.

Last but not least, allow me to thank the organisers of the National Seminar on Minority Shareholder Value for inviting the Securities Commission to deliver this keynote address on the topic of the importance of good corporate governance in the context of developing an internationally competitive and highly efficient capital market. I am sure that all present will find the seminar a fruitful and successful one.

Ladies and Gentlemen,

Thank you for your attention.

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