FEATURE ARTICLE: **CORPORATE GOVERNANCE PRACTICES IN MALAYSIA CONTINUE TO IMPROVE**

BY PROFESSOR MAK YUEN TEEN

Malaysia last revised its *Malaysian Code on Corporate Governance* (MCCG) in April 2021 and in doing so, became one of the first countries in the world to integrate sustainability governance and management practices into the corporate governance code.

The 2021 revision of the MCCG also saw a number of other enhancements, including extending the recommendation for the boards of large listed issuer[1] to comprise at least 30% female directors to all listed issuers; an annual two-tier vote for independent directors serving beyond nine years; and discouraging the Chairman from being a member of the Audit, Nomination or Remuneration Committees. This continues the trend of Malaysia leading many of its regional peers in corporate governance reforms.

Malaysia has formulated rules that are not only aligned with those in developed markets but in some cases have gone beyond, in order to address issues that it sees as pertinent to its listed issuers. The recommendation that the Chairman should not be a member of the three key board committees is a case in point. It is one of the few countries, if not the only one, that has incorporated such a recommendation in its Code. This was introduced to reduce the risk of dominance of the Chairman in committee deliberations and to improve independence and objectivity in such deliberations. While smaller boards may find it difficult to comply, the recommendation is aimed at addressing a real risk not only in Malaysian companies, but in companies everywhere. It is good to see the adoption levels for this recommendation improving across companies of different sizes. It is important that companies that do not comply take steps to ensure that committee deliberations and recommendations are not hindered by a dominant Chairman.

Malaysia is also one of the few countries where the regulators publish regular reports on compliance with their code of corporate governance. This is important not only for identifying gaps in compliance and where further targeted actions by regulators and other stakeholders may be necessary, but can also point the way to future reforms.

[1] Large listed issuer is defined under the MCCG as companies on the FTSE Bursa Malaysia Top 100 Index or companies with a market capitalisation of RM2 billion and above, at the start of the companies' financial year.

Greater board independence can be further encouraged

The *Corporate Governance Monitor 2024* shows that the percentage of independent directors has settled at just over 50% over the past few years, with the percentage of executive directors remaining at just over 30%. While the percentage of independent directors is at a healthy level, what is more important is to ensure that these directors are truly independent.

Although only 28 PLCs have a board Chairman who is also the CEO, there are still 29% of PLCs with an Executive Director serving as the Chairman. In the latter cases, the Executive Chairman may also be effectively acting as the CEO, even if there is another individual holding the CEO position. This means that the recommended practice of the positions of Chairman and CEO being held by different individuals may be followed in form rather than in substance.

The independence of the board will be further compromised if companies with an Executive Chairman also have a relatively high percentage of executive directors. Listed issuers should consider reducing the presence of executive directors on their boards.

Gender diversity continues to improve

Malaysia has been a flag bearer for gender diversity on boards in the region, and we continue to see the percentage of female directors improving not only for the Top 100 PLCs, but all PLCs. All-male boards are becoming nearly extinct, with only eight PLCs and 1 Top 100 PLC, having such boards, due to resignations. With the Listing Requirements now mandating all PLCs to have at least one female director, all-male boards will be a thing of the past.

The percentage of PLCs with at least 30% female directors now stands at about 37%. More can be done by PLCs to achieve the 30% target, and even surpassing it. What is encouraging is that we are seeing women accounting for more than 40% of all new appointment of independent directors as of October 2024.

Beyond numbers and percentages, it is important that boards ensure that female directors appointed to boards are given sufficient support and encouragement to contribute to board deliberations and decisions. In this regard, the Board Chairman plays a crucial role. More female directors holding key board positions such as board and committee chairs would be a further sign of progress.

Improving the search and nomination process

Efforts to improve gender diversity and other forms of diversity should be underpinned by a robust search and nomination process, which involves boards casting the net wide to identify candidates who bring skills and competencies needed by the board, together with a diversity of perspectives. It is good to see around 85% of PLCs complying with Practice 5.6 on not solely relying on recommendations from existing directors, management or major shareholders in identifying candidates for board appointments, or to explain why these sources suffice and other sources were not used. However, it is unclear what percentage of companies did not use independent sources and explained why they were not used.

PLCs should be encouraged to ensure that their search and nomination process supports the board in having an appropriate mix of skills and experience and diversity of perspectives, and the appointment of directors who are fit and proper, do not have conflicts or potential conflicts of interest, and are truly independent.

Healthy signs of board renewal and new blood

It is encouraging that the latest statistics show that nearly two-thirds of independent directors appointed as of October 2024 are first-time directors. In 2023, that percentage was nearly 70%. This is important not only from the perspective of continuing to increase the pool of independent directors, but it also helps mitigate the risk of overboarding as there would be more choices available to companies. It also helps support board renewal and companies to implement term limits for independent directors.

The fact that more than 40% of first-time directors are women also augurs well for continuing improvement in diversity.

Malaysia is showing the rest of the region that there are many candidates, including women, who are qualified and available to serve as independent directors. With the appropriate professional development and support, these newer directors can contribute to more effective and future-ready boards for Malaysian PLCs. Improving other aspects of diversity, such as age diversity, is also important for building more effective boards.

What next for Malaysian boards?

Going forward, Malaysian boards should continue to focus on improving corporate culture to enhance both compliance and performance. While the MCCG states that the board should work together with senior management to promote a good corporate governance culture within the company which reinforces ethical, prudent and professional behaviour, poor corporate culture continues to be the root of many corporate governance scandals around the world. Boards should seek more information from management that can provide insights into corporate culture, such as turnover and absenteeism rates; how employees are recruited, rewarded and promoted; and whistleblowing, grievance and "speak-up" data. Boards should assess whether indicators of a good corporate culture such as honesty, openness and respect exist in their companies and be alert to indicators of poor corporate culture, such as silo thinking, dominant/arrogant leadership and pressure to meet numbers and overambitious targets.

In terms of performance, initiatives in various countries such as Japan and South Korea to push companies and boards to implement measures to increase corporate value are prompted by lackluster value creation in many companies. As the high-level finance committee report published in Malaysia 25 years ago states, the purpose of corporate governance is to promote business prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value while taking into account the interests of other stakeholders. Many boards may have lost sight of their responsibility to promote business prosperity, focusing predominantly on compliance, which whilst important, is not the ultimate purpose of corporate governance. To encourage boards to focus more on long-term value creation, regulators can consider requiring better disclosures of appropriate metrics related to value creation and steps that companies and boards will take to improve such metrics. While improving transparency in remuneration policies and packages for senior executives is important, what is just as important is that these remuneration policies support the creation of long-term value. Boards should review whether there is an appropriate balance between fixed salary, short-term incentives and long-term incentives that are aligned to developing an appropriate corporate culture and encouraging a focus on value creation.

Finally, boards should review the processes they have in place for ensuring that the board has the appropriate composition to properly oversee the integration of sustainability considerations into the business and deal with current and emerging risks their companies are likely to face. The recent proposed revision of the corporate governance recommendations in Australia has focused on the need for an accurate assessment of the skills and competencies on the board, in particular, what it takes for a director to be considered to have a particular skill or competency. Current board skills matrices used by many companies as part of the search and nomination process may not adequately assess the current and required skills and competencies required. This will undermine the ability of companies to build truly effective boards.

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