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CORPORATE GOVERNANCE AND DEBT IN THE MALAYSIAN FINANCIAL CRISIS OF 1997-98

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CORPORATE GOVERNANCE AND DEBT IN THE MALAYSIAN FINANCIAL CRISIS OF 1997-98

This study attempts to define the concept of corporate governance and evaluates its position against the background of the Malaysian legal system and its company law regime. Because corporate governance has assumed a wide posture in recent years and has drawn core principles, traditionally belonging to the subject of company law, into its parameters, this study is limited to two aspects of the decision-making process of companies, that is, how directors borrow large sums of money for their companies, and whether shareholders are kept informed of such borrowings.

Corporate governance issues received a powerful impetus when the Asian financial and economic crisis hit four countries, Indonesia, Thailand, South Korea and Malaysia, with severity in 1997. Different causes have been attributed for the crisis in the four countries. At the same time, there are features common to all of them. In the case of Malaysia, there is unanimous agreement on the role of private debt, principally by companies, and that companies whose shares are listed for trading on the two boards of the Kuala Lumpur Stock Exchange ("KLSE") caused distress to the banking system, which triggered the collapse from July 1997. Our study reviews data publicly available around 1997 for a few selected KLSE companies on their borrowing policies and practices, and the disclosures of such borrowings to their shareholders.

CORPORATE GOVERNANCE

Corporate governance describes the ways and means by which the government of a company (the directors) is responsible to its electorate (the shareholders). Directors who take decisions on behalf of a company are, in varying degrees, accountable or responsible to others affected by their decisions, including the company itself, shareholders, creditors and the investing public. Corporate governance is thus concerned with the decision making process of a company. The quality of corporate governance is thus inextricably linked to accountability; hence, the greater the accountability, the better the corporate governance. Conversely, the lesser the accountability, the poorer the corporate governance.

Because the company is the vehicle of choice of businessmen driving the private sector, and because corporate governance is critical to competitive performance in all a company's markets (goods, services, capital and human resources), the quality of corporate governance affects the dynamism of the private sector and, in turn, the credibility of market economies in achieving economic growth and promoting citizens' welfare. It is therefore not surprising that corporate governance has become an important topic for discussion at national, regional and international levels.

As the management of a company by its directors and other senior officers has far reaching consequences, the first pre-condition for a proper study of corporate governance is an understanding of the process of managing a company. The management of a substantial business enterprise is a complex and dynamic process requiring continual responses by necessarily fallible human agents operating under competitive conditions usually in flux. The Internet and e-commerce are recent manifestations of dramatic changes which have always characterized the business environment. The law, or legal regime, has an important role in underpinning a desirable system of corporate governance by providing legally definitive prescriptions that should accommodate the predictable and reliable exercise of authority under market conditions characterized by uncertainty and competitive pressure.

The task of adapting, refining and adjusting corporate governance is necessarily an ongoing process. To be competitive, companies must be allowed to innovate and adapt their governance practices to new economic circumstances. Thus, corporate governance should be viewed as never completed work in progress. To promote flexibility, experimentation and continuous improvement, the design of corporate governance relationships and practices should be left to market forces: corporate governance should remain essentially subject to decisions by individual actors in the private sector. While the need to protect investor rights is undisputed, market-driven solutions emerging from competition among alternative practices are generally superior to those mandated by regulating authorities. That said, law should serve as the ultimate deterrent: however, for such law to enjoy the requisite public confidence, strict and impartial enforcement by the relevant authorities should take place when breaches of the law occur, irrespective of personality.

The subject of corporate governance has become fashionable in the last decade of the 20th century, and now covers issues relating to corporate and company law. Select Committees, comprising distinguished personalities, have already issued comprehensive reports on the subject in the United Kingdom, Australia, South Africa and Canada; the Cadbury, Hampel, Bosch, Day and King Reports are examples. In Malaysia, a high level Finance Committee issued a detailed report on the subject in February 1999.

This study has focused on public companies, as opposed to private companies. Their contribution to the economic and financial wellbeing of Malaysia cannot be exaggerated. Indeed, from the cradle to the grave, the affairs of ordinary Malaysian citizens are unbelievably affected by decisions taken by faceless companies. There is no doubt that the joint-stock company (as opposed to partnerships and sole proprietorships), as an institution, plays the greatest role in the business and economic affairs of Malaysia. Rather than deal with the myriad businesses operated by hundreds of thousands of companies, it is more manageable and probably meaningful to concentrate on the 790 odd companies whose shares are listed for trading on the KLSE. In addition to being the largest of Malaysian companies, they also have a direct duty to the investing public.

The demarcation between shareholders, as owners of an enterprise, and the directors, who control and direct the business of the company, was established centuries ago, early in the history of the Anglo-Saxon company. According to company law and practices, directors set the strategic directions for the company. That is, after all, why they are called directors. Directors of public companies are expected to appoint good management and to monitor performance. Directors should put the interests of the company ahead of their own. Our study proposes to consider how, insofar as it can be measured, directors of Malaysian listed companies discharged their duties in the recent crisis. Did directors act with honesty and probity? Did they exercise reasonable care, diligence and skill? Did they have “the interests of the company” uppermost in their minds when they exercised discretion? Did they disregard their personal interests when deciding for the company?

A key feature of the 1997 crisis, at least in Malaysia, was the scale and magnitude of private sector debt. In 1997, the proportion of such debt to GDP was 170%. A very large proportion of such debt was corporate debt, principally borrowings by companies listed

on the KLSE, and sometimes, short-term borrowings to fund long-term projects. There is consensus that poor or ineffective corporate governance in these companies was a major contributing factor to such ill-advised investment decisions.

Two core corporate governance issues for KLSE companies in the context of the 1997 crisis are considered in this study. First, the ways and means by which these companies borrowed large amounts from the banking sector. Secondly, the manner in which directors held meetings of shareholders and the amount of explanation or information disclosed to shareholders at such meetings; in other words, whether shareholder democracy and their right to make informed decisions meaningfully existed among public listed companies in Malaysia. The emphasis on KLSE companies has added value since borrowing decisions made by directors of these companies impact upon the many members of the public who are shareholders, unlike the case of a typical private limited company which has a very limited range of shareholders, usually members of a family or a small group of people known to one another, where most shareholders are also directors, and hence, should be aware of borrowing decisions in their capacity as directors.

THE MALAYSIAN LEGAL SYSTEM

By the standards of developing nations, Malaysia has a sophisticated legal system based on common law bequeathed to it by its formal colonial power, Great Britain. The British occupation of Penang in 1786 was followed very quickly by the imposition of the English legal system administered by judges and lawyers from England. A local court system was established in the early 19th century, with the final court of appeal being the Privy Council in London. Direct links with the English judicial system continued for a substantial period after Malaysia obtained independence in 1957. Appeals from the Courts of Malaysia to the Privy Council only ceased in 1986.

One consequence of Malaysia being a member of the common law world (as opposed to a completely indigenous system or one based upon the French or German civil law system) is that Acts of the Malaysian Parliament, especially in the corporate and commercial areas, have always been modelled on similar acts in England, India and Australia. Further, although not binding on Malaysian courts, case law – that is, decisions of the leading Courts of England, Australia, India, Canada, New Zealand and

Singapore – are given much weight by Malaysian courts and are certainly of persuasive value. Thus, the shared experiences of common law jurisprudence are of tremendous value to our legal system.

The primary Act of Parliament governing companies is the *Companies Act, 1965*.[1] It is modelled on the Companies Act, 1948 of England and the Uniform Companies Act, 1960 of Australia. It is a detailed text with more than 370 Sections and Nine Schedules. Subsidiary legislation, in the form of Rules and Regulations, has been enacted under the Companies Act. The Companies Act has also been amended on numerous occasions; indeed, some observers take the view that what is perhaps needed is a completely new Companies Act, and not piece-meal ad hoc amendment exercises that have taken place in the last three decades. The *Securities Industries Act, 1983* and the *Securities Commission Act, 1993* are two other statutes that directly affect the governance of companies. Other laws that also ought to be considered in this context are the Code on Takeovers and Mergers, the Kuala Lumpur Stock Exchange Rules and the Foreign Investment Committee Guidelines.

THE COMPANY LAW REGIME IN MALAYSIA

It is vital for a proper understanding of corporate governance to appreciate that, in law, the powers of a company are distributed between the board of directors and the shareholders, or members who meet in general meetings providing a system of checks and balances. Directors are entrusted with general management of the business of the company; they take all decisions relating to the business of the company, including investing monies belonging to the company and borrowing for the company. Powers vested in the general meeting of shareholders under the *Companies Act, 1948*, on the other hand, relate to taking fundamental decisions for the company, such as:

1. amendments to a company's Articles and Memorandum of Association (Sections 31 and 28);
2. changes in the nature of the company, for example, from unlimited to private limited (Section 25) and from private to public, or vice versa (Section 26);
3. reduction of share capital (Section 64);
4. removal of directors of a public company (Section 128);

5. approval for disposal of substantial or the whole of the company's undertakings or property (Section 132C);
6. approval of the issue of shares by directors (Section 132D); and
7. resolving that the company be wound up by the court (Section 218 (1) (a)) or voluntarily (Section 254 (1) (b)).

Statute law is not exhaustive. Thus, one would also have to look to decided cases for a complete picture of the law relating to power sharing between directors and shareholders (and, indeed, for every aspect of company law). Malaysian courts have established a respectable body of case law for over a century that serves as precedent. Further, major company law cases from other jurisdictions form part of the law of Malaysia, having being accepted by Malaysian courts as good law. The list includes *Salomon v. Salomon & Co. Ltd*[2] and *Ebrahimi v. Westbourne Galleries Ltd*[3] from England, *Howard Smith Ltd. v. Ampol*[4] from Australia and *Canadian Aero-Service Ltd v. O'Malley*[5] from Canada.

Minority shareholders can challenge the decisions of directors or a company in a variety of legal actions, including under general law and under Section 181, and can apply to wind-up a company under Section 218 of the *Companies Act*. A director owes various duties to the company, including a duty of care, fiduciary duty, a duty to act honestly, a duty to take into account the interests of the company, and a duty to avoid conflict of his private interests with the interests of the company. Breaches of such duty are enforceable, in many ways, by the company, and in some instances, by individual shareholders.

Observations by judges on conduct expected in law of directors are legion. By way of illustration, we offer three recent examples:

The Privileges of Incorporation

> "The concept of limited liability and the sophistication of our corporate law offers great privileges and great opportunities for those who wish to trade under that regime. But the corporate environment carries with it the discipline that those who avail themselves of those privileges must accept the standards laid down and abide by the regulatory rules and disciplines in place to protect creditors and

shareholders. And, while some significant corporate failures will occur despite the directors exercising best managerial practice, in many, too many, cases there have been serious breaches of those rules and disciplines, in situations where the observance of them would or at least might have prevented or reduced the scale of the failure and consequent loss to creditors and investors.

Reliable figures are hard to come by, but it seems that losses from corporate fraud and mismanagement have never been higher. At the same time the regulatory regime has never been more stringent – on paper even if not in practice."

Henry L.J.[6]

"Those who trade under the regime of limited liability and who avail themselves of the privileges of that regime must accept the standard of probity and competence to which the law requires company directors to conform."

Neill L.J.[7]

Individual and Collective Responsibility of Directors

"Mr. Davies also submitted, correctly, that the collegiate or collective responsibility of the board of directors of a company is of fundamental importance to corporate governance under English company law. That collegiate or collective responsibility must however be based on individual responsibility. Each individual director owes duties to the company to inform himself about its affairs and to join his co-directors in supervising and controlling them."

"It is of great importance that any individual who undertakes the statutory and fiduciary obligations of being a company director should realize that these are inescapable personal responsibilities. The appellants may have been dazzled, manipulated and deceived by Mr. Griffiths but they were in breach of their own duties in allowing this to happen."

Lord Woolf M.R.[8]

Duties of Directors

"(i) Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's

business to enable them properly to discharge their duties as directors.

(ii) Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from duty to supervise the discharge of the delegated functions.

(iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."

Jonathan Parker J.[9]

It is settled law that a company's power to borrow, invariably exercised by its directors, must be used in good faith for the benefit of the company, and not for purposes other than those for which it has been conferred. If the power is not exercised in the interests of the company, the loan cannot be recovered by a person lending with notice of the purpose for which it is to be applied. If, however, the lender had no notice, he may recover the loan since he is not bound to inquire how the borrowed monies is to be applied.

In Re Instruction Ltd. is a good illustration. From the time of its incorporation in 1951 to 1958, the company in that case carried on the leisure business. In 1958, new directors and shareholders took over control of the company, and in 1960, embarked on a new business, that of pig breeding, financed by a bank which was provided its Memorandum of Articles of Association and which was informed that its only business was that of pig breeding. The company became insolvent and was wound up by the Court in 1965. The liquidator challenged the borrowing and contended that as the bank was aware of the business of pig breeding which was not expressly specified in the objects clause of the Memorandum of Association, the bank should not be able to recover the loan. The liquidator succeeded, both in the High Court and Court of Appeal of England.

> "Now to borrow money, by itself, without intending to use the money for any purpose, would be a senseless operation…. Borrowing is only a sensible activity if it is associated with some use to which the borrowed money is proposed and intended to be put… the power to borrow or raise money is a power to borrow or raise money for the purposes of the plaintiff company."
>
> per Buckley J.[10]

> "The Judge based his judgment, I think, on the view that a power or an object conferred on a company to borrow cannot mean something in the air: borrowing is not an end in itself and must be for some purposes of the company; and since this borrowing was for an ultra vires purpose; that is an end of the matter."
>
> per Harman L.J.[11]

A company is, of course, not a trustee of its own funds: it is its beneficial owner; but in consequence of the fiduciary character of their duties, the directors of a company are treated as if they are trustees of those funds of the company which are in their hands or under their control, and if they misapply them, they commit a breach of trust. See *Belmont Finance Corporation v. Williams Furniture Ltd (No. 2)*[12] and *Lian Keow Sdn. Bhd. v. Overseas Credit Finance Sdn. Bhd.*[13]

The world wide trend to confer rights to aggrieved persons to bring civil actions to recover compensation or damages by reason of wrongful dealing of shares traded on a stock exchange (rather than a criminal prosecution by the State), has been followed in Malaysia by recent amendments to the *Securities Industry Act, 1983* (SI Act). Thus, any person:

(i) who creates or causes false trading or market rigging transactions (Section 84 of the SI Act);

(ii) who engages in or carries out transactions which have the effect of manipulating prices of shares of a KLSE company (Section 85);

(iii) who makes a statement or disseminates information which are false or misleading (Section 86); or

(iv) who fraudulently induces other persons to deal in securities (Section 87);

not only faces the peril of criminal prosecution, but also now runs the risk of civil liability under Section 88A, which empowers any person who has suffered loss or damage as a result of any of the actions described above to sue the person responsible for causing such loss. The Securities Commission may also institute civil proceedings under Section 90 against persons in breach of any of the provisions in Sections 84, 85, 86 and 87 of the SI Act. The Securities Commission is also empowered under Sections 90 and 90A to sue persons responsible for insider trading, and the Court, in such actions, is empowered to order damages and compensation against such insiders and others who aid and abet them.

This very brief summary of the Malaysian legal regime will indicate that, by and large, the legal structure is more than sufficient to attain good corporate governance. Parliamentarians worldwide believe that the first (and often, in their view, only) solution to any problem is legislative change. Thus, any number of persons have suggested, in the wake of the 1997 crisis, that the panacea for all the ills facing Malaysian companies is more statute law. On the contrary, the best way to command the confidence of investors (both foreign and local) and the general public is by educating directors and shareholders of their rights and obligations, and by enforcing – strictly, evenly and impartially – existing law, rather than rushing to law reform. In the final analysis, Malaysian law in this area is very similar to that in England and Australia. Yet, corporate governance in those countries is by, any objective yardstick, in a much superior state to that prevailing in Malaysia.

THE REGULATORY AUTHORITIES

Malaysian companies may be subject to as many as three specialized regulatory authorities, viz, the Registrar of Companies (ROC), the KLSE and the Securities Commission (SC). The office of the Registrar of Companies was established in 1898. The incorporation of every company, whether private or public, is effected with the ROC, whose jurisdiction thus extends to all companies incorporated in Malaysia. The principal duty of the ROC is to ensure that companies and their officers comply with the numerous provisions of the Companies Act and the subsidiary legislation made thereunder. Documents evidencing decisions or transactions of a company are filed with the ROC for public inspection. The ROC is accorded extensive powers of enforcement under the Companies Act, including the right to enter into premises, to seize documents

and records, and to compel oral testimony of witnesses. The ROC reports to the Minister of Domestic Trade.

The KLSE was established in 1973. It is a self-regulating organization that governs the conduct of public companies whose shares are listed for trading on the Main Board or Second Board of the KLSE. It also enforces the listing and disclosure requirements.

The SC, like the KLSE, comes within the purview of the Minister of Finance and regulates the affairs of some 790 public companies whose shares are listed for trading on the KLSE, and public companies applying for listing status with the KLSE. It was set up in 1993. The powers of the SC include:

?? regulating take-overs, mergers and acquisitions of companies;
?? ensuring proper conduct by companies and their officers;
?? promoting the development of the securities and future markets;
?? taking all necessary steps to protect the interests of investors; and
?? enforcing the compliance of relevant laws.

As one would expect, there is some degree of overlap and duplication of the jurisdictions of the three regulatory authorities over public listed companies, which inevitably leads to conflicting positions on issues and organizational clashes over turf. Further, the Attorney General is conferred discretion under Article 145 of the Federal Constitution, which is the supreme law of the land, to institute or discontinue criminal proceedings, including prosecution of white-collar crime. Another government agency concerned with corporate governance is the office of the Official Receiver (OR), which is responsible for the winding-up or liquidation of companies. The OR is invariably liquidator of most companies wound up by the Court; the common ground for winding up a company being its insolvency, that is, an inability on the part of the company concerned to pay its debts. The OR is given wide powers to investigate any wrongdoing that may have led to liquidation, including the power to recover the properties of the company from its officers.

ROLE OF COMPANIES IN MALAYSIA'S ECONOMY

That the company is the preferred choice for Malaysian businessmen is amply demonstrated by the fact that, as of 31st December 1999, 512,450 companies were incorporated with the ROC. Of this total, less than 4,000 are foreign companies, and only 790 are public listed companies on the KLSE, with 493 on the Main Board and 297 on the Second Board. Thus, the vast majority of companies, nearly 99% of those incorporated, are private limited companies managed by Malaysians. Estimates vary from about 300,000 to 350,000 of private limited companies actually carrying on business in Malaysia. Statistics do not exist to show the extent of the role of companies to the economy of Malaysia.

Although the KLSE companies represent a miniscule fraction in percentage terms of the total number of companies carrying on business in Malaysia, their importance in value terms to the Malaysian economy cannot be over-emphasized. The 790 companies command a massive proportion of the national wealth. Their market capitalization in October 2000 exceeded RM500 billion, equivalent to two years' national output (GNP). The investing public, including – indirectly – through Amanah Saham Nasional and other mutual funds, numbers in the millions. Finally, and perhaps most importantly for the purposes of this study, KLSE companies constitute the biggest users of loan funds (principally bank borrowings) and account for the major portion of non-performing loans currently plaguing Malaysia's national financial system. Thus, one commentator of the Malaysian corporate sector observed:

> "The country's NPL problem is largely a public companies' problem. The high coincidence of loan defaults and technical insolvency among listed companies reflect several deep-seated weaknesses which need to be addressed…."[14]

MALAYSIA IN CRISIS, 1997

The opinion expressed by Linda Lim[15] is as good a summary of the state of the Malaysian economy just prior to the July 1997 crisis as any:

> "At the onset of the Asian financial crisis in July 1997, Malaysia was the most open of the five most severely-hit Asian crisis economies, the others being Thailand, Korea, Indonesia and the Philippines. Exports accounted for 70% of

GDP, import barriers were relatively low (with the notable exception of automobiles) and declining, and in the 1990s the country had received more foreign direct investment as a share of GDP than any other in the world. It had an open capital account, with full exchange convertibility allowing the free inflow and outflow of domestic and foreign capital. Domestic economic fundamentals were also strong, with a high savings rate at 38% of GDP, low inflation, and a government budget that was typically balanced or in surplus. Government macro-economic management, private financial institutions, infrastructure and education were superior to those in most neighbouring countries. Foreign exchange reserves were healthy.

"Not surprisingly, after eight years of close to 9% annual real GDP growth, Malaysia had become a darling of foreign portfolio investors as well as direct investors of all nationalities, but predominantly Americans and Japanese, who had long given it the equivalent of "triple-A" ratings as a manufacturing investment location. It was widely hailed as a model of openness and market-orientated development, and for four decades had had a popular elected government with a track record of sound economic management."

Yet, the crisis hit Malaysia with speed and ferocity. Between the first week of July 1997 (at RM2.50 = US$1.00) and January 1998 (at RM4.88 = US$1.00), the ringgit depreciated by almost 50% against the dollar. The stock market collapse was even greater. In the same six month period, the stock market experienced the biggest plunge of all the Asian crisis countries, losing over 65% of its capitalization, wiping almost US$225 billion off share values, and the composite index plunging 54% from 1,230 points to 574 points. The economy nose-dived into a recession that saw a decline in real GDP of 8% in 1998, following an average growth rate of about 8% in each of the previous eight years.

What happened to Malaysia? Did it simply fall victim, as some politicians proclaim, to a wild speculative attack in the wake of the Thai crisis, or were there, as in the view of some other observers, some fundamental weaknesses in the pre-crisis Malaysian economy that made it vulnerable to the Thai spillover? According to a penetrating study,[15] an international financial crisis affects a particular country when its foreign asset

holders try to dump assets, usually securities or bank deposits denominated in that country's currency. A country succumbs to such a crisis from a position of vulnerability, in which there is real room for differences of opinion in the market about its ability to defend the currency in the event of a speculative attack. A state of vulnerability does not give rise to a crisis by itself. There needs to be a certain disturbance – a trigger – that will transform a vulnerable situation into an actual collapse. Conversely, a country should be able to ride out an attack if it is not vulnerable. Thus, of the 15 countries in East Asia and South East Asia, only four (Korea, Indonesia, Thailand and Malaysia) were severely hit.

In explaining the unfolding of the crisis in Malaysia in 1997-98, one should avoid a one-dimensional approach. In other words, there is no single factor that explains the collapse. Some of the factors that pointed to clear signs of vulnerability in Malaysia's economy in June 1997 were a significant appreciation of the real exchange rate (suggesting deterioration in international competitiveness), a build-up of short-term foreign borrowings, a low level of reserves, and fundamental weaknesses in the banking and financial systems.

THE BANKING CRISIS IN MALAYSIA

Of these causes, the crisis that affected Indonesia, South Korea, Thailand[16] and Malaysia in 1997-98 has been attributed to weaknesses of the banking systems. For this school of thought, the crisis started much earlier in the decade. The banking systems of the four countries would have met their fate at one point of time regardless of the crisis that, by contagion, hit each of them at the same time in 1997. Views expressed by four experts are reproduced herein.

> "The economic, financial and political turmoil that struck Asia in mid-1997 represents both a crisis and a panic. The crisis was one of fundamentals. It is a growth crisis. At its core were antiquated financial systems that relied almost exclusively on commercial banks to provide capital for economic expansion. These institutions, very highly leveraged and poorly repudiated for the most part, could no longer support the high growth that most of the region had sustained for nearly two decades."

"The main reason why the banking systems are so weak lies in the quality of financial management. Most commercial banks of Asia are run like pawnshops. Proper credit culture, meaning lending upon the basis of reasoned credit and cash flow analysis, is minimal. Rather collateral is king, and the primary factor in the lending decision. The other reason is the relationship between bank and customer. At best, the focus on relationship results in 'name lending', or making credit decisions primarily on the basis of the bank officers' assumed knowledge of the customer in question. Such knowledge may involve a real understanding of the customer's business and the character of managers. At its worst, name lending deteriorates into related party lending and crony capitalization. Under such circumstances, depositors and minority shareholders tend to get short shrift. Bank owners milk deposits, friends of friends of the well connected get loans and creative accounting becomes an art form."

"…there is ample justification to blame the crisis, in the aggravated manifestation that we have seen, on the weaknesses of Asia's banking systems in a context of high growth. We have witnessed nothing other than an implosion of the banking and financial systems."

Philippe Delhaise[17]

"Not since the crash of 1929 have bank regulators round the world dealt with so many post-asset bubble banking crises – with the old story of over-leverage, boom and bust. The only major difference in the 1990s was the depth of the crisis, the speed and spread of the contagion regionally and then globally.

Banking problems do not happen overnight, they have very complex roots. Many of the factors are country-specific and originate in defective structural or policy factors. Moreover, bank problems involve political, sectoral, legal, social, institutional and incentive dimensions. What was dynamite was the mixture of over-leverage, inadequate bank supervision, opacity and misunderstanding of risks in many markets, lack of sound bankruptcy laws and panic capital flight. Globalisation, technology and financial innovation have increased the conditions for large capital flows in the midst of weak corporate governance, outdated laws, policies and institutional structures. The outflow triggered the collapse."

Andrew Sheng[18]

"The banking crisis that is now unfolding has been caused by the rapid expansion of credit, over-exposure of the banking system (of around 40% of its loan portfolio) to the volatile property and share markets, weak management (caused by continued restrictions on hiring and pay), weak supervision (again caused partly by the same hiring constraints) as well as the failure of the authorities to improve Malaysian banking standards towards international best practice and align the incentives of owners, managers and depositors with prudent banking (thus failing to cash in on the buoyant economy and continue the major banking reforms of the second half of the 80s)."

R. Thillainathan[19]

"These recent crises have underscored certain financial structure vulnerabilities that are not readily assuaged in the short run but, nonetheless, will be increasingly important to address in any endeavor to build formidable buffers against financial stress. Among the most important, in my judgment, is the development of alternatives that enable financial systems under stress to maintain an adequate degree of financial intermediation even should their main source of intermediation, whether banks or capital markets, freeze up in a crisis.

This leads one to wonder whether East Asia's recent problems would have been less severe had those economies not relied so heavily on banks as their principal means of financial intermediation. One can readily understand that the purchase of unhedged short-term dollar liabilities to be invested in Thai baht domestic loans (counting on the dollar exchange rate to hold) would at some point trigger a halt in lending by Thailand's banks. But did the economy need to collapse with it? Had a functioning capital market existed, the outcome might well have been far for more benign.

Before the crisis broke there was little reason to question the three decades of phenomenally solid East Asian economic growth, largely financed through the banking system, so long as rapidly expanding bank credit outpaced lagging losses and hence depressed the ratio of non-performing loans to total bank assets. The

> failure to have alternative forms of intermediation was of little consequence so long as the primary means worked. That is, the lack of a spare tire is of no concern if you do not get a flat. East Asia had no spare tires. The United States did in 1990 and again in 1998.
>
> Banks, being highly leveraged institutions, have, throughout their history, periodically fallen into crisis. When these institutions were the sole source of finance, their difficulties often pulled their economies down as well."
>
> Alan Greenspan[20]

By the early 1990s, the Malaysian banking system had developed two signs of weakening prudential norms – rapid expansion of bank loans and heavy exposure to the broad property sector (real estate, construction and share trading). The annual rate of growth of bank lending to the private sector increased continuously, from 18% in 1990 to 33.5% in 1997. Private sector debt in Malaysia increased by nearly 200 times, or by an average annual growth rate of 61% from RM395 million in 1987 (0.5% of GDP) to RM75 billion in 1998 (26.5% of GDP). As of January 2000, outstanding private debt securities amounted to RM120 billion.[21] The level of outstanding credit relative to GDP increased from an average of 85% during the late 1980s, to 120% in 1994 and 160% in 1996-97. The peak attained, when the crisis broke in mid-1997, was 170%, which was the proportionately highest credit build-up among the four crisis countries. Two dangers are apparent in such a massive build-up of credit. First, the international market considers it an indicator of official decision-makers' reluctance to use interest rates as a policy tool in the event of a speculative attack on the currency. Secondly, a rapid build-up of credit in a relatively short period suggests a growing share of lending to less creditworthy borrowers, itself a sign of weakening in the banking system.

This rapid credit expansion was accompanied by a sharp increase in the share of total credit going to the broad property sector. By the end of 1996, this sector accounted for over 45% of total outstanding bank loans. An additional factor that weakened Malaysia's banking system, and thus increased its vulnerability, was the growing dominance of local, relative to foreign banks. It had been national policy for decades that local banks should dominate: thus, no new licenses to carry on banking activities in Malaysia had been given for decades. Foreign banks with a presence in Malaysia were prohibited from

opening new branches; and only local banks could open new branches in Malaysia. With the foreign banks' networks frozen, new deposits gravitated to local banks. In consequence, the share of foreign banks in total bank deposits declined from over 80% in the early 1970s to a mere 30% by the mid-1990s. Ironically, when the currency crisis was at its worst in late 1997 and early 1998, ordinary Malaysians, by the thousands, moved their deposits from local to foreign banks, which were perceived by the man in the street as being safer. The few incidents of runs on financial institutions at that time were against Malaysian owned banks or finance companies. None of the foreign banks were affected.

The real estate market became increasingly fragile in the years leading up to 1997. Office and retail sub-sectors were already facing oversupply in 1995. Nonetheless, planning approvals were granted liberally by the local authorities, while credit was generously extended by banks and other financial institutions, and companies and businessmen all diversified into real property. The result would have been a substantial oversupply of office, retail and residential space over the 1999-2000 horizon even if the 1997-98 crisis had not occurred.

Finally, there had been rapid expansion of the share market in Malaysia in the decade up to 1997. Just prior to the crisis, with a market capitalization of around US$200 billion, the Kuala Lumpur Stock Exchange was the third largest in the Asian Pacific region, after Tokyo and Hong Kong. In relation to the GDP, stock market capitalization – at over 300% of GDP – was substantially higher than anywhere else at any time in history.

Prema-Chandra Athukorala notes: "Thus, the Malaysian experience is consistent with the prediction of the currency crisis literature that excessive credit growth is a source of vulnerability to a financial crisis."[22]

Despite the crisis from mid-1997, severe unemployment did not result and the export-oriented manufacturing, particularly the electronics sector, continued to perform impressively. Exports were enhanced by the flourishing US economy which is a substantial importer of Malaysian exports. The currency peg of RM3.80 to the dollar has meant that Malaysian exports have been highly competitive. Inflation rates throughout the three-year period have remained low. Even socioeconomic problems caused by the

presence of over two million foreign workers, mostly from Indonesia, constituting more than 20% of the total work force, have not been severe. Admittedly, some foreign workers returned to their homelands, but the large majority remained and somehow eked out a living. Hence, the most tangible evidence of the 1998 recession has been the level of private sector debt default, particularly by corporate borrowers (as opposed to individuals), the reduction in domestic consumer spending and demand, and finally, the decrease in foreign tourists visiting Malaysia, which has had adverse results for those in the hotel and leisure business.

MORAL HAZARD

Moral hazard, as we understand it, is simply any situation in which A makes a decision about how much risk to take, while others bear the costs if things go wrong.

An illuminating account of moral hazard in Asian banks is given by Paul Krugman:[23]

> "Just open a bank, making sure that it has an impressive building and a fancy name. Attract a lot of deposits, by paying good interest if that is allowed, by offering toasters or whatever if it isn't. Then lend the money out, at high interest rates, to high-rolling speculators (preferably friends of yours or maybe even yourself behind a different corporate front). The depositors won't ask about the quality of your investments, since they know that they are protected in any case. And you now have a one-way option: if the investments do well, you become rich; if they do badly, you can simply walk away and let the government clean up the mess.
>
> "What we also should have noticed was that the claim that Asian borrowing represented free private-sector decisions was not quite the truth. For Southeast Asia, like Japan in the bubble years, had a moral hazard problem – the problem that would soon be dubbed crony capitalism.
>
> "Let's go back to that Thai finance company, the institution that borrowed the yen that started the whole process of credit expansion. What, exactly, were these finance companies? They were not, as it happens, ordinary banks: by and large they had few if any depositors. Nor were they like Western investment banks,

repositories of specialized information that could help direct funds to their most profitable uses. So what was their reason for existence? What did they bring to the table?

"The answer, basically, was political connections – often, indeed, the owner of the finance company was a relative of some government official. And so the claim that the decisions about how much to borrow and invest represented private-sector judgments, not to be second-guessed, rang more than a bit hollow. True, loans to finance companies were not subject to the kind of formal guarantees that backed deposits in US savings and loans. But foreign banks that lent money to the minister's nephew's finance company can be forgiven for believing that they had a little extra protection, that the minister would find a way to rescue the company if its investments did not work out as planned. And the foreign lenders would have been right: in roughly nine out of ten cases, foreign lenders to finance companies did indeed get bailed out by the Thai government when the crisis came.

"Now look at the situation from the point of view of the minister's nephew, the owner of the finance company. Basically, he was in a position to borrow money at low rates, no questions asked. What, then, could be more natural than to lend that money at a high rate of interest to his friend and real estate developer, whose speculative new office tower just might make a killing – but then again might not. If all went well, fine: both men would have made a lot of money. If things did not turn out as hoped, well, not so terrible: the minister would find a way to save the finance company. Heads the nephew wins, tails the taxpayer loses.

"One way or another, similar games were being played in all the countries that would soon be caught up in the crisis. In Indonesia, middlemen played less of a role: there the typical dubious transaction was a direct loan from a foreign bank to a company controlled by one of the president's cronies. (The quintessential example was the loan that broke Hong Kong's Peregrine Investment Holdings, a loan made directly to Suharto's daughter's taxi company.) In Korea, the big borrowers were banks effectively controlled by *chaebols*, the huge conglomerates that have dominated the nation's economy and – until very recently – its politics.

> Throughout the region, then, implicit government guarantees were helping underwrite investments that were both riskier and less promising than would have been undertaken without those guarantees, adding fuel to what would probably anyway have been an overheated speculative boom."

In August 2000, Malaysia's Deputy Prime Minister Dato Seri Abdullah bin Hj. Badawi, acknowledged the role of moral hazard in Malaysia.

> "It is a fact, that both you and I know, that the government engaged in many rescue operations during the crisis. A more laissez-faire government would have allowed many of our key companies to sink."
>
> "But if another crisis were to happen in the future, I am not so sure that we will be able to insulate ourselves and recover in the manner we did this time around. To put it simply, the government may not be able to afford another round of rescues. It is for this reason that the business community must realize that there can no longer be a moral hazard situation. As we face globalisation and move into a knowledge-based economy, time and money cannot be wasted on rescuing the mediocre in the future, there will be less insurance against failure."
>
> "I am well aware of the rumblings and discontent among the professional business community that the government should not continue to protect those who have blatantly mismanaged their corporate empires and have repeatedly come back crying for help. I am aware that these criticisms are being made by Malaysians themselves and not merely by the foreign media or by foreign analysts ad I am aware that many of these criticisms are valid."[24]

THE DEBT PROBLEM IN THE CORPORATE SECTOR

Two examples of corporate borrowing of awesome proportions in Malaysia that have received much publicity and are also relatively better documented involve the Renong Group and Perwaja Steel. Twelve KLSE companies constitute the Renong Group. They have business interests as diversified as toll-road operations, property, construction, financial services, telecommunications and oil and gas. As of June 2000, the Renong Group owes its banks a whopping RM20 billion, which apparently makes up 5% of total

loans extended by the Malaysian banking sector. The capital intensive projects undertaken by the Renong Group have included the North-South Highway, the Malaysia-Singapore Second Link and the Putra Light Rail System. Three members of the Group, Renong Bhd, Putra Bhd and Time Engineering Bhd, each owe more than RM4 billion.[25] What is unclear from public records is the income that members of the Renong Group intended to generate in the years to come in order to repay a debt of such magnitude. Although sales of assets have also been publicly mentioned from time to time, the level of debt seems to have remained at well over RM20 billion since the crisis broke in mid-1997.

Perwaja Trengganu Sdn Bhd[26] was incorporated in 1982 as a joint venture between the state-owned Hicom Bhd and Nippon Steel Corporation of Japan to signal Malaysia's entry into steel making as a centerpiece of the state-led heavy industrialization drive. In December 1995, an internal audit report, which became public, disclosed that Perwaja was insolvent, and was unable to pay any interest, let alone the principal, on its RM5.7 billion in domestic and foreign borrowings. A change of the top management took place in 1996. Despite cost-cutting measures, Perwaja's plant operations in Trengganu apparently lose about RM35 million a month. Fifteen years after it produced its first steel, Perwaja has yet to show a single ringgit in profit. According to a report prepared by the Accountant General and presented to the Malaysian Parliament, Perwaja's net liabilities at the end of 1998 had increased to RM9.1 billion, made up of RM4 billion owed to the government and RM5.1 billion owed to financial institutions and guaranteed by government. Among the financial institutions is a local bank with an exposure of RM1.9 billion and the Employees Provident Fund.

Tangible evidence of financial distress of KLSE companies includes the following publicly known facts[27] relating to assistance sought because of inability to service debts:

1. 55 KLSE companies have successfully applied to the High Court for orders under Section 176 of the *Companies Act, 1965* relating to Schemes of Arrangements with their creditors. Of this total, 33 companies are listed on the Main Board while 22 are on the Second Board. As of July 2000, all the counters were suspended from trading; although the reasons for such suspension (which is in the discretion of SC and KLSE) may not be related to the pending Section 176 proceedings;

2. The majority of the 75 applications submitted to the Corporate Debt Restructuring Committee (CDRC) came from KLSE companies. The total value of their debt is about RM45 billion; however, the proportion attributable to KLSE companies has not been disclosed;
3. Special Administrators have been appointed by Pengurusan Danaharta Nasional Bhd (Danaharta) acting under its powers pursuant to the *Pengurusan Danaharta Nasional Act, 1998* (the Danaharta Act) over 18 KLSE companies – ten from the Main Board and the balance from the Second Board. Trading of the shares of all 18 companies has been suspended. Under the Danaharta Act, the Special Administrators, who are independent accountants from well established firms, have full responsibility for management of the 18 companies in place of the directors during the period of special administration which, under the Danaharta Act, is for a minimum period of one year, and is invariably extended for about 2 or 3 years. The Special Administrators are obliged to prepare work-out plans with the creditors of the companies concerned;
4. As of August 2000, loans acquired by Danaharta under the Danaharta Act totaled about RM46 billion, of which about RM38 billion was from banks. This constituted 43% of the non-performing loans of the banking system. A breakdown of the loans of KLSE companies and non-KLSE companies is not available; and
5. As of August 2000, Danamodal had injected RM7.6 billion into 10 banks.

CASE STUDIES OF FOUR KLSE COMPANIES

For our micro-level study, we focus on four public listed companies selected on a purely random basis. Three companies were large-scale borrowers, while the fourth company is a bank. The shares of three companies trade on the Main Board of the KLSE, while the fourth company's shares are listed on the Second Board. The case studies will focus on how directors, most of whom represent major shareholders, take decisions on behalf of the four companies relating to borrowing (and lending in the case of the bank), with particular emphasis on the following matters:

1. why directors made decisions to borrow large sums of monies, and whether they were, in fact, necessary;
2. the purposes for which the borrowings were made, and whether the monies were actually used for the said purposes;

3. whether the loan monies were actually for the benefit of the companies;
4. the extent and time of disclosures made by the directors to the shareholders about such borrowings; and
5. whether, the company was objectively in a financial position to repay such borrowings, and, if so, the time-scale for full repayment.

The data for our study are from public records, namely the Annual Reports published by the four companies for the benefit of its shareholders and potential investors. Some of these Annual Reports have also been filed with the ROC, SC and KLSE. In order to preserve anonymity, we have referred to them as Company A, Company B, Company C and Bank X.

Company A

The shares of Company A have been trading on the Main Board for more than 20 years. It has diversified business activities that include insurance, timber, engineering and property.

Board of Directors ("Board")

Significant changes occurred in the Board from 1995 to 1998 with management control moving to a single family. The major shareholder of Company A is the father of all the related directors. The composition of the Board is as follows:

	Year	Executive Directors	Independent Directors	Total
1.	1995	5 (2 are related) 2 appointments	4	9
2.	1996	7 (3 are related) 3 resignations	4 2 resignations	11
3.	1997	4 (3 are related)	2 1 resignation 1 appointment	6
4.	1998	4 (3 are related)	2	6

No reasons were given in the Annual Reports for the reduction of directors from 10 to 6 within 3 years and for the dominance of one family in management. Thus, in 1998, 3 of the 6 directors were members of a family, all of whom held executive positions. The total interest, direct and indirect, of the said family in the share capital of Company A was about 85%.

Audit Committee

In 1996, the three independent directors comprised the Audit Committee. In 1997, an executive director of the controlling family joined the committee. There was no information in the Annual Reports on the number of meetings of the Audit Committee, or on the matters they discussed or the recommendations the Committee made.

Directors' Report

According to the Directors Report forming part of the Annual Report for 1996, Company A carried out the following two significant transactions:

1. purchase of a building for a cash consideration of RM63 million; and
2. acceptance of an offer to purchase shares worth RM240 million in another KLSE company.

No reasons were disclosed in the Annual Reports for the said investments, how they were to be funded and how they would add shareholder value.

Borrowings

Company A's borrowings in the period 1995 to 1998 are tabulated below:

	1995	1996	1997	1998
Unsecured				
Term Loans	–	–	15	15
Bank Overdrafts & Revolving Credits	32	81	154	117
	32	81	169	132
Secured				
Term Loans	50	208	53	249
Bank Overdrafts & Revolving	–	–	–	40

Credits				
Share Margin	–	–	4	3
	50	208	57	293
	82	289	225	424
Long Term & Deferred Liabilities	51	59	358	153
Total Borrowings	133	348	593	677

Note: All figures in RM million.

The Annual Reports for the three years ending 31st December 1998 are significant for their omissions with regard to these borrowings. Thus, with regard to secured loans, there is only a general statement on the type of security and the assets secured. There is no information on the purposes for which these borrowings were made, what use was made of the borrowed monies (that is, the manner of disbursement of the loans), and the persons who took the decisions to borrow.

Throughout this period, shareholders' funds remained constant at RM140 million. According to the financial statements forming part of the Annual Reports, although the business turnover of the group, to which Company A belongs, increased from RM266 million in 1996 to RM314 million in 1997, the group reported a loss of RM56 million in 1997. No explanation was given in the financial statements for such loss. Incidentally, the group's investments, particularly in the real property and share sectors, increased from RM191 million in 1995 to RM466 million in 1996. The accounts do not give any breakdown on the financial positions of individual member(s) of the group; instead, the group's accounts were consolidated.

Disclosure of borrowings in the Annual Reports of Company A is limited to general statements to the effect that:

?? the borrowings of the group were secured with the assets of unnamed subsidiary companies,

?? the range of interest rates (between 8% to 12.25% per annum) on the borrowings.

Company B

Company B's shares have been listed for trading on the Main Board for a decade. It too belongs to a group of companies engaged in businesses as diversified as property development, leisure (hotel, resort and golf), healthcare services and engineering works. As the holding company of the group, Company B's revenue is wholly dependent on the performance of companies actually engaged in various businesses.

Board Composition

According to Annual Reports for the years 1995 to 1998, at least two major changes took place in the shareholding structure of Company B in that period. Essentially, controlling shareholder status moved from an individual to a group of companies with which the individual shareholder had previously been associated with. This seems to have been reflected on the Board, which saw its membership fluctuate from 5 to 8 members during the relevant period. Some information on the qualifications and background of the directors was given in the Annual Reports.

Audit Committee

The Annual Reports disclosed that this committee had only one member during the relevant period, contrary to the requirement that it should consist of at least two members, both of whom should be non-executive directors. There were no reports by the one-man committee relating to the Committee's performance over the period in question.

Borrowings

The financial statements in the Annual Reports of Company B for the five-year period 1994 to 1998 state that its borrowings were as follows:

	1994	1995	1996	1997	1998
Short Term Loans					
Revolving credit – Unsecured	32	---	16	60	20
Current portion of term loans – Secured	24	58	---	53	89
	56	58	16	113	109
Term Loans					
Secured	88	393	544	488	499
Unsecured	3	1	9	38	7
	91	394	553	526	506
Bank Overdrafts					
Secured	39	33	57	66	61
Unsecured	2	47	3	49	74
	41	80	60	115	135
Total Borrowings	188	532	629	754	750

Note: All figures in RM million

Information disclosed in the Annual Reports of Company B's borrowings reveal general statements pertaining to the types of security given for the borrowings, including fixed or floating charges. Fixed deposits with banks and securities of KLSE companies are also disclosed. So are the rates of interest charged. Some information relating to repayment by installments is also mentioned. Similar kinds of information are also given for the company's unsecured loans.

Both management teams revalued upwards the assets of Company B for the purpose of charging them as securities for loan facilities. Interestingly, reference was made in the Annual Reports that some of the company's borrowings were to be used by both management teams to pursue bailouts, giving brief reasons for such expenditure. The question of how it would serve the interest of Company B was, however, not addressed. Information was given that such expenditure was to diversify the business of the group. Finally, there were substantial investments in shares in the five years under review.

Company C

Company C is an investment holding company and its subsidiaries are in the business of manufacturing and trading garments. The group has been in active business for nearly 30 years. The shares of Company C are listed on the Second Board of the KLSE.

Board

	Year	Executive Directors	Non-Executive Directors	Total in Board
1.	1995/96	5 (3 resigned) (2 became non-executive)	4 (4 resigned) (3 appointed) (2 became non-execuitve)	9
2.	1996/97	---	5 (1 resigned)	5
3.	1997/98	---	4 (2 resigned) (3 appointed)	4
4.	1998/99	---	5	5

The board shift in 1996 reflected a sale of substantial shares by a major shareholder. One of the directors appointed in 1997 also became Chairman of the Board and apparently commanded shares of about 20% of the total share capital of Company C. No reasons were given in the Annual Reports for the changes in management. There was hardly any write-up on the qualifications of any of the directors; a reader of the Annual Reports would receive no information on the credentials of any of the directors and whether any of them were qualified to manage Company C.

Audit Committee

The Committee had three directors in 1996, two of whom were non-executive and the other was the managing director. From 1997, the three newly appointed non-executive directors became members of the Audit Committee. The Committee issued no report in the Annual Report; hence, there is no information on the number of meetings they held, the matters they deliberated upon and their recommendations, if any.

Borrowings

The Annual Reports of Company C for the four-year period 1995 to 1998 describe its borrowings as follows:

	1995	1996	1997	1998
Term Loan				
Repayable within 12 months included under current liabilities	3.4	4.2	2.1	1.6
Repayable after 12 months included under current liabilities	3.5	4.5	5.0	6.7
	6.9	8.7	7.1	8.3
Short Term Bank Borrowings				
Bills Payable	6.6	9.5	12.5	5.1
Revolving Loans	---	8.0	33.5	13.9
Short Term Loans	---	---	---	20.5
	6.6	17.5	46.0	39.5
Bank Overdraft				
Secured	1.7	0.3	0.2	0.5
Unsecured	2.3	3.0	7.3	7.0
	4.0	3.3	7.5	7.5
Total Borrowings	17.5	29.5	60.6	55.3

Note: All figures in RM million

The disclosures in the Annual Reports of Company C relating to borrowings is terribly scanty. The notes to the accounts which appear in the financial statements of the Annual Reports merely state, as a matter of fact, that term loans, short term loans and overdrafts were taken out by Company C, without ever explaining the reasons for the borrowings and how they would serve the interests of the company. Some information on the types of security created for the borrowings and the rates of interest charged are disclosed in the Annual Reports.

No explanation was given in respect of a major transaction relating to the acquisition of companies to complement the garment business of Company C. Likewise, no information was recorded in the Annual Reports which would throw light on the increase in the debt from RM4.6 million in 1996 to RM18.7 in 1997.

Bank X

The shares of the ultimate holding company of Bank X are listed for trading on the Main Board of the KLSE. As is typical in Malaysia, Bank X also has a merchant bank and a

finance company in its stable. There are also other related companies all engaged in providing financial services of one kind or other.

Board

The composition of the board of directors of Bank X for the three year period, 1994 to 1997, was as follows:

Year	Executive Directors	Non-Executive Directors	Total on Board
1994/95	8	1	9
1995/96	8	3	11
1996/97	8	3	11

The Chairman and Deputy Chairman are related and have been in their posts since 1991. They are both chartered accountants. The qualifications of the other directors are impressive; they include prominent businessmen and retired civil servants.

Audit Committee

According to the Annual Reports, the Audit Committee in 1995 comprised one independent director and two non-executive directors, while in 1996 and 1997, a fourth member, an independent director, was added to the list. As in the other companies, the Annual Reports do not contain any information on whether the Audit Committee actually met in any of the years under review, and, if so, the matters they discussed, and whether the Committee had made any recommendations, and, if so, whether the Board accepted and implemented any of the recommendations.

Loan Committee

Most banks have in place committees which approve loans over a certain figure. Thus, one can imagine a branch manager approving up to, say, half a million ringgit; a regional manager RM1 million; intermediate committees approving facilities of, say, RM2 million or RM5 million, and a high level committee at the Bank's head office approving loans of more than, say, RM10 million. Some such structure is necessary in any bank. If one were to review the Annual Reports of Bank X, one would not be able to ascertain

any information about the Loans Committee, and the approving authority levels at each tier.

Directors' Reports

The Chairman of the Board of Directors disclosed in the Directors' Report that he controls 45% of the paid-up share capital of Bank X. The Annual Reports disclose that there were continuous capital raising transactions by Bank X ranging from directors and employee share option schemes, ICULS, conversion from ICULS to ordinary shares, bonus issues and rights issues.

The declaration of dividends in this period is significant:

1994-1995	24.3%
1995-1996	27.5%
1996-1997	17.5% (after bonus issue)

No explanation is given for the decisions to declare dividends, and the quantum of the dividends, particularly in circumstances when other members of the group also declared dividends which benefited the same group of shareholders. One wonders whether the option of retaining profits as capital in Bank X was ever considered by the Board. With the benefit of hindsight, it is likely that the capital injection from Danamodal may have been smaller if the said dividends had not been paid-out.

The Banking and Financial Institutions Act, 1989 (BAFIA) provides that all banks should publish in the major national newspapers quarterly, six-monthly and annual financial results. However, the Annual Reports of Bank X only provide consolidated group results; the financial results of Bank X are not produced as a stand-alone. Neither are BAFIA's requirement complied with in the Annual Reports. Such publication may take place elsewhere, but one would have thought that it would be consistent with prudent banking and transparency to also publish them in the Annual Reports.

Bank X's principal business, as one would expect, is lending. Its loan growth for the period from 1994 to 1997 was spectacular; 38% in 1995 compared to 1994, 50% in 1996 compared to 1995, and 46% in 1997 relative to 1996. Although its Annual Reports state

that its policy was to diversify its loan portfolio across various types of customers and industries so as to diversify risk exposure, it actually had a very heavy concentration of loans in real estate and construction (ranging from 21% to 23% in each of the years under review) and for "finance, insurance and business services" (ranging from 17% to 23% in the said years). One suspect that loans to purchase shares, including share margin financing, come under this category; none of the other categories would be appropriate. The Annual Reports proudly proclaimed that Bank X's loan growth was among the highest in the Malaysian banking sector. In the corresponding period, growth in deposits saw increases of 35%, 58% and 32% respectively.

What is striking in the Annual Reports of Bank X is the complete lack of explanation for the substantial increase in loans and advances in this period, the type of customers to whom facilities were extended, and the kinds of credit risks undertaken by the Bank when making the advances. At the least, one would have expected a list of the top 10 borrowers of the Bank and the level of their exposure. No meaningful understanding can be obtained of Bank X's credit policies and the checks and balances it carries out prior to making loans if one reviews the Annual Reports. Any potential investor wishing to invest in the shares of Bank X would be no wiser about the practices and style of business of Bank X if he or she were to review the Annual Reports. When one realizes that hardly any other information is readily available in the public domain about Bank X, one wonders what factors a prudent investor takes into account when deciding whether to purchase the shares of Bank X. In such an environment, how does an investor make an informed decision whether to purchase, hold or sell the shares of Bank X?

Is it therefore of any surprise that Bank X reported a loss of about RM1 billion in 1999 when compared to a profit before tax of about RM1 billion in 1997. After making provisions for bad and doubtful debts and non-performing loans totalling about RM2 billion in 1999, it sought recapitalisation from Danamodal.

General Meetings of the Four Companies

The principal purpose of a general meeting of the shareholders of a company is to provide a forum for its directors to report on their stewardship of the company for the year under review, and for shareholders to seek explanations from directors on any matter pertaining to the business or affairs of the company. A review of the Annual

Reports of the four companies confirms that the only reference therein to general meetings of shareholders, invariably, the Annual General Meeting, is to reproduce the Agenda, for the Annual General Meeting, which by coincidence all seem to be of the following format:

"1. To receive and adopt the Directors' Report; and Audited Accounts for the year ended 31st March 19…;

2. To re-elect the following Directors who retire by rotation pursuant to Article …… of the Company's Articles of Association:
   (a) Mr A; and
   (b) Mr B.

3. To re-elect the following Directors who retire pursuant to Article …… of the Company's Articles of Association:
   (a) Mr. X; and
   (b) Mr Y.

4. To approve the payment of Directors' fees in respect of the year ended 31st March 19…;

5. To approve a first and final dividend of ……% less tax for the year ended 31st March 19…;

6. To re-appoint Messrs OPQ as Auditors and to authorize the Directors to fix their remuneration;

7. To transact any other business for which due notice shall have been received."

The paucity of information relating to meetings of shareholders is evidenced by the fact that none of the Annual Reports contains the minutes of any general meetings held in the previous year. Hence, one cannot discover by reading the Annual Reports whether any discussion of any matter took place at any of the general meetings. Shareholder democracy manifests itself at general meetings; if shareholders do not avail of the opportunity given to them once a year, to attend such meetings or to ask questions of management, can shareholders then legitimately complain of poor corporate governance on the part of the directors? One can only speculate whether the decision to exclude the minutes of meetings from the Annual Reports (if the directors or those who are responsible for the publication of the Annual Reports had in fact addressed their minds to the matter) is because the minutes may be only 2 or 3 pages long, do not contain

anything meaningful and may only prove embarrassing reading. Hence, Datuk Megat Najmuddin's description[27] of annual general meetings of KLSE companies as "10 minute affairs with a handful of people" seems apt.

General Observations of the Four Companies

Our case studies of Companies A, B and C indicate that scanty information was made available to shareholders in the Annual Reports for the period in question with respect to the scale and magnitude of borrowings by the companies. Thus, no information is given in the Annual Reports on the following crucial matters:

1. the companies in the group that were actually borrowing, as opposed to the whole group;
2. the reasons for the borrowings, and whether other options for raising finance had been considered by the directors;
3. how the companies used the loan monies;
4. how the companies benefited from such borrowings;
5. how shareholder value was enhanced by the borrowings; and
6. how and when the loans are to be repaid.

Hence, there was no communication of material information to shareholders.

A review of the agenda confirms that the subject of borrowings by the company was never included as a specific agenda item in any of the Annual Reports. Hence, the only opportunity for a shareholder who attended any AGM to ask questions about borrowings would be under the item "general" on the Agenda. Anecdotal evidence suggests that questions are seldom posed or matters raised under such a rubric at AGMs of KLSE companies. If this was indeed the case in respect of Companies A, B and C, then corporate governance with regard to their massive borrowings did not exist to any meaningful degree in these companies.

Against this background, one cannot but agree with Tan Sri Ali Abul Hassan, then Governor of Bank Negara Malaysia, on the cavalier approach to borrowings displayed by both directors and shareholders of Companies A, B and C.

"The recent crisis has taught us many invaluable lessons that are applicable not only to the banking sector but also to the corporate sector as a whole. While it is easy to blame the banks for their reckless lending in the past, the borrowers too should share part of the blame.

"Many, for instance, utilized their borrowings for purposes other than those declared to the banks. Loans for working capital were used for share financing, to finance new business ventures or became a complex web of inter-company advances. By the time the annual review of the loans are carried out, the level of leverage in the company had ballooned and the business focus of the Group had expanded so much that it altered significantly the risk profile of the Group.

"There were also instances where borrowers purposely reneged on their loans although they had the capability and capacity to repay their loans. Whilst there had been many initiatives to improve the credit culture in banking institutions, similar efforts should be initiated to promote a more responsible credit behaviour among the borrowers."[28]

Significantly, our study of Bank X's Annual Reports supports the view expressed by Philippe Delhaise that generally in Asia, the degree of disclosure by banks is wanting. According to him,[29] in 1993, Capital Information Services, Asia's largest bank rating firm and the predecessor of Thomson Bank Watch Asia, developed a model to measure the extent banks were disclosing relevant information in their annual reports. The model was a scoring sheet giving a subjective weighting to every aspect of bank accounting disclosure, including non-quantitative information. Table 1[30] was the result.

Table 1:Disclosure of Information in Asian Banks, 1993

	P & L	*Liabilities*	*Assets*	*Other figures*	*Non-figures*	*Total*
Thailand	94	93	144	96	15	442
Malaysia	87	90	110	96	40	423
Indonesia	75	118	107	72	29	401
Taiwan	90	100	84	80	45	399
Philippines	67	74	77	96	21	335
South Korea	54	101	94	24	56	329

	P & L	*Liabilities*	*Assets*	*Other figures*	*Non-figures*	*Total*
Hong Kong	9	19	27	8	31	94
China	13	18	7	0	0	38
Max. Possible Score	200	210	350	120	120	1000

In the survey conducted by an independent rating firm, there was only one line about deposits (the total) in most Annual Reports. There was no indication as to whether deposits were from banks or small depositors, or as to the proportion of savings deposits or similar information. It was impossible to attempt analysis of a bank's liquidity. The same went for profit, with only one line on net profits. According to Delhaise, even that information was of no use, since banks were routinely squirreling away – in inner reserves – funds they thought they might need in leaner times. For the same reason, in his view, the capital ratios were all wrong.

The same observations can be made about the Annual Reports of Bank X. Hardly any information is given therein about the scale and magnitude of its lendings, the identity of its principal borrowers and whether securities were secured for such borrowings. Although statistics relating to the holding of securities by banks over assets and properties of borrower companies do not exist, anecdotal market evidence is that banks in the 1993 to 1997 period seldom sought securities, whether in the form of National Land Code charges over immovable properties or debentures over other properties and assets, from borrowers who were KLSE companies. In fact, even guarantees from directors of such companies were not obtained. The financial environment in that period (when most loans which turned sour after July 1997 were actually approved and monies disbursed) was such that banks were encouraged by the government to lend as much as possible, and KLSE companies seemed to be the safest and best customers. Thus, in that period, it was banks that wooed "good" corporate customers, and not vice-versa. Prudence and caution were dispensed with by banks in the name of attaining loan growth. The chickens only came home to roost in late 1997.

Andrew Sheng[31] summarized the situation as follows:

> "The quality of information of banks has been hampered by the lack of international accounting and valuation standards and their enforcement, and generally accepted rules of transparency and access to information. In addition to the inadequate information, there was not only lack of incentives to use information, but also in many emerging markets, the lack of capacity to absorb or digest the new information. I would summarize the information question as bad accounting = bad information = poor decision making = bad risk management = financial crisis."

Our survey of the role of the Audit Committee in the Annual Reports lends support to the concern voiced by Datuk Megat Najmuddin Khas[32] of the lackadaisical approach of KLSE companies to internal audit when commenting on a recent survey of internal audit and risk management – conducted by MICG, the Institute of Internal Auditors, Malaysia and Ernst & Young – on 120 KLSE companies which revealed that 28% of them did not have internal audits. Datuk Megat queried: "In most cases, public listed companies have an audit committee but it does not have internal audit function. If it does not have an internal audit function, how would the company operate?"[33]

Datuk Megat's frustrations were ventilated in stronger language in July 2000:

> "Public company directors are quite a mixed bag academically and otherwise! For too long, we have witnessed many episodes of corporate shenanigans. The performance of some public listed companies' boards leaves much to be desired, even the so-called more 'professional' ones. Look at the recent court proceedings involving corporates. The many instances of negligence, ignorance, lack of skill and incompetence exhibited by directors of public listed companies, especially the so-called independent non-executive directors are appalling.
>
> It is no wonder that nowadays, foreign investors shy away from our stock market. In fact, the directors can count their lucky stars that our minority shareholders are not litigation conscious. Otherwise, they will find themselves being dragged to Court for failure to carry out their fiduciary duties under Section 132 of the

Companies Act, 1965, which does not make a distinction between non-executive and executive directors. All are liable! Remember, ignorance of the law, as we all know, is no excuse."[34]

Costs of Corporate Governance

Many analysts claim that one principal factor deterring foreign equity investors, who were net sellers of Malaysian stocks in 2000, is the slow pace of corporate restructuring (including failures to change management) and poor corporate governance. Foreign investment in the KLSE dried up in 2000. Even after its return to the Morgan Stanley Capital International indices earlier this year and the gradual lifting of controls for the repatriation of profits, the KLSE continues to be shunned by most foreign fund managers. Mangal Goswami[35] asks:

> "Is restructuring really being done? What is the sentiment among foreign investors? Are fund managers putting money back into Malaysia? …The stock market hasn't seen much of an up move, despite strong liquidity in the banking system, because of slow pace of restructuring."

A second result of poor corporate governance is the declining level of foreign direct investment (FDI), which has been sluggish since 1997. That year the value of FDI applications was down 18.4% from 1996. It continued to fall by 12.2% in 1998 and 28.4% in 1999. Approvals have also been slow to recover; they were down 33% in 1997, up 14% in 1998 and down 6% in 1999.[36]

Yet another consequence of poor corporate restructuring is the fall in returns to capital in Malaysia. A study of companies in 10 countries in Asia during the pre-crisis and post-crisis eras reveals that the return to capital fell from 16% to 12% while countries like Hong Kong, Singapore and Taiwan have recorded an increase over the same period. "There's a lot of capital which is not being used to generate profits, so return to capital tends to fall" claims Manu Bhaskaran.[37] According to him, poor corporate governance and lack of adequate restructuring made it difficult for Malaysian companies to yield high returns; "…there is not enough of corporate restructuring, such as a change of management, which is needed in the long term."

Conversely, a recent survey by the international management consultancy, McKinsey & Co.[38] suggests that institutional investors are actually prepared to pay a premium for good corporate governance. Its survey revealed that international investors are prepared to pay a mark-up of more than 20% for shares of companies that achieve good corporate governance. In such companies, a majority of directors come from outside the company, have no ties to management and receive most of their remuneration in the form of stocks or options. They are likely to have formed an evaluation process for their directors and to be responsive to investors' requests for information on governance issues. Apparently, the results were based on information received from more than 200 institutional investors in the United States, Europe, Asia and Latin America managing some US$3.25 trillion in assets. Interestingly, more than 80% of the investors who responded to the McKinsey study say they would pay more for the shares of a well-governed company than those of a poorly governed company with comparable performance. The size of that premium varies, with 27.1% in Indonesia, 25.7% in Thailand, 23.8% in Malaysia and 20.2% in Taiwan and Japan.

Directors of Malaysian companies should take heed. Even if Malaysian companies could only capture a small proportion of the "governance premium" that seems available, they would create significant shareholder value. Further, companies with poor governance will find themselves at a competitive disadvantage when it comes to attracting capital to finance growth. In the concluding words of the McKinsey Report: "High governance standards will prove essential to attracting and retaining investors in globalised capital markets, while failure to reform is likely to hinder those companies with global ambitions."

Whether good corporate governance will be advanced in the forthcoming months may be answered by the unfolding of events related to an apparent attempt by Tan Sri Halim Saad, Chairman of the Renong Group, to take Renong Bhd private by purchasing all the shares that do not presently belong to him. Tan Sri Halim now owns 16.5% of Renong's shares. According to media reports,[39] the buy-out of the remainder of Renong's equity will be done in stages and may cost him as much as RM5 billion. Issues of good corporate governance abound with regard to financing the share purchase. Market talk, which seems to have been reflected in the media, suggests two sources of financing: i) Khazanah Nasional, the state-owned investment vehicle, and ii) a consortium of banks.

One of the lessons of the Asian crisis is that banks should lend on the basis of cash flow, rather than on more esoteric concepts such as net asset value. What is the real cash flow position here? Further, even if little "new" money may be involved in the borrowing exercise as it may merely involve changing the borrower from a company (Renong Bhd) to an individual (Tan Sri Halim) without actually disbursing money, the important corporate governance issue from the lender's perspective is the risk involved in having an individual as a borrower, rather than a KLSE company. Is the lender in a better position if this happens?

Corporate governance issues would also indirectly come to play when Morgan Stanley Capital International announces, probably in December 2000, a plan to adjust its stock indices to reflect the size of the "free float" in each market. The free float, which refers to the value of shares not held by long-term, large stakeholders, indicates relative liquidity, and, as such, is more sophisticated than the current MSCI method of calculating market size purely on the basis of market capitalization. This may have an immediate negative effect on KLSE companies, which have a high proportion within its ranks of 790 companies, of government backed entities (like Khazanah, PNB, or EPF) or of founding families owning large blocks of shares that will be deleted from MSCI's weighted indices. According to a market player,[40] there may be a significant one-time migration of portfolio investment, which, sources speculate, may be as high as US$21 billion within Asia. Apparently, the global MSCI weighting of the United States and United Kingdom will swell at the expense of Japan and Hong Kong. According to her, within the Asia-Pacific region covered by the MSCI Far East ex-Japan index, the clear winners will be China and Taiwan, and countries like Malaysia, Thailand and Indonesia, with excessive cross shareholdings or pyramid structures in a "top down" environment, will suffer most.

An example of good corporate governance is the enunciation of 13 Business Principles in 1983 by Warren Buffet, Chairman and Chief Executive Officer of Berkshire Hathaway Inc, reproduced in *An Owner's Manual*, circulated to every shareholder of Berkshire Hathaway. No country can pass a law to compel a director to share his ideas of governance in the comprehensive manner that Warren Buffet has done. We have selected 8 of his 13 Principles to give a flavour of what, I believe, directors in Malaysia should strive for to attain good corporate governance.

"1. Although our form is corporate, our attitude is partnership. Charlie Munger and I think of our shareholders as owner-partners, and of ourselves as managing partners. (Because of the size of our shareholdings we are also, for better or worse, controlling partners.) We do not view the company itself as the ultimate owner of our business assets but instead view the company as a conduit through which our shareholders own the assets.

2. In line with Berkshire's owner-orientation, most of our directors have a major portion of their net worth invested in the company. We eat our own cooking.

3. Our long-term economic goal (subject to some qualifications mentioned later) is to maximize Berkshire's average annual rate of gain in intrinsic business value on a per-share basis. We do not measure the economic significance or performance of Berkshire by its size; we measure by per-share progress.

7. We use debt sparingly and, when we do borrow, we attempt to structure our loans on a long-term fixed-rate basis. We will reject interesting opportunities rather than over-leverage our balance sheet. This conservatism has penalized our results but it is the only behavior that leaves us comfortable, considering our fiduciary obligations to policyholders, lenders and the many equity holders who have committed unusually large portions of their net worth to our care.

8. A managerial 'wish list' will not be filled at shareholder expense. We will not diversify by purchasing entire businesses at control prices that ignore long-term economic consequences to our shareholders. We will only do with your money what we would do with our own, weighing fully the values you can obtain by diversifying your own portfolios through direct purchases in the stock market.

9. We feel noble intentions should be checked periodically against results. We test the wisdom of retaining earnings by assessing whether retention, over time, delivers shareholders at least $1 of market value for each $1 retained. To date, this test has been met. We will continue to apply it on a five-year rolling basis. As our net worth grows, it is more difficult to use retained earnings wisely.

11. You should be fully aware of one attitude Charlie and I share that hurts our financial performance: regardless of price, we have no interest at all in selling any good businesses that Berkshire owns. We are also very reluctant to sell sub-par businesses as long as we expect them to generate at least some cash and as long as we feel good about their managers and labour relations.

12. We will be candid in our reporting to you, emphasizing the pluses and minuses important in appraising business value. Our guideline is to tell you the business facts that we would want to know if our positions were reversed. We owe you no less. Moreover, as a company with a major communications business, it would be inexcusable for us to apply lesser standards of accuracy, balance and incisiveness when reporting on ourselves than we would expect our news people to apply then reporting on others. We also believe candor benefits us as managers: the CEO who misleads others in public may eventually mislead himself in private."

Good corporate governance of banks is the *sine qua non* of a secure banking system. Banks in mature systems have attempted to attain good governance by establishing a governance committee whose purpose is to enunciate and enforce in broad terms its corporate governance practices. It is usually composed of independent directors. The committee evaluates CEO performance on a continuing basis.

In the telling words of Walter Wriston, himself a highly successful Chief Executive of a bank, "I used to tell the guys on the Citibank board that their essential role was to hire and fire the CEO."[41]

In addition, the governance committee can coordinate the board and the board member performance evaluation process by peer review, that is, where directors evaluate each other. Thus, at a minimum, the governance committee is an attempt at preventive medicine.

Finally, our review of the Annual Reports of the four KLSE companies lends credence to views expressed by regulators[42] and seasoned observers[43] that:

1. KLSE companies are still managed along the lines of the "one-man" company whose sole shareholder/director makes all the decisions for the company;
2. there is a poor shareholder spread;
3. minority shareholders, even institutional investors, usually take little or no interest in the affairs of their companies. Shareholder passivity encourages directors to ride roughshod over them in the confident knowledge that shareholders' indifference would result in no action whatsoever being taken against the directors or company; and
4. diversification of business appears to be the norm, with little emphasis being paid to concentrating on core business; instead, the temptation of venturing into the property market cannot be resisted.

CONCLUSION

Accountability of the directors of KLSE companies to shareholders, which is the ultimate essence of corporate governance, only has practical meaning if major decisions taken by directors, like large scale borrowings for companies, are explained to shareholders. Although the Malaysian financial crisis of 1997-98 had many causes, the scale and magnitude of private sector debt, particularly of KLSE companies, was a fundamental cause. If the lack of written explanations to shareholders in Annual Reports and at Annual General Meetings of the four companies by the directors of their borrowing decisions is characteristic of the majority of the 790 KLSE companies, there is cause for concern. It would mean that one important section of a KLSE company's constituency, the investing public, was neither consulted nor informed about major corporate decisions, which affects the company's solvency and its very existence, with far-reaching consequences for the investing public. A real consequence is that members of the public who purchased shares in the KLSE companies which have been suspended[44] from trading because of their financial distress cannot sell their shares; they have effectively been locked in for an inordinate period of time. The free transferability of shares is prejudiced by such suspension. Apart from injuring contractual rights of sale, this operates unfairly on the investing public, particularly since the reason for most suspension of trading is "insolvency", which is invariably caused by the reckless borrowing decisions of directors who do not inform shareholders of such decisions, let alone their consequences.

When presenting the 2001 Budget to Parliament on 27th October 2000, Tun Daim Zainuddin, the Minister of Finance was merely articulating informed public opinion when he noted "However, I regret that the move to improve corporate governance has been viewed with cynicism." Perhaps a way forward against such cynicism is to apply, without exception, civil and criminal law in the corporate sector when breaches occur, as hinted by Dato Seri Abdullah bin Hj. Badawi:

> "Transparency and an improved corporate governance regime after the crisis must be implemented effectively by concerned authorities. Here, I pledge the government's commitment to stamp out corruption both in the private and public sectors. If we need to make examples of prominent corporations or individuals, we will do so."[45]

Time will tell if this pledge is honoured, and the state of corporate governance in Malaysia is enhanced.

Notes

1 The evolution of the *Companies Act, 1965* is set out in Appendix 1.
2 [1897] AC 22 [HL].
3 [1973] AC 360 [HL].
4 [1974] AC 821 [PC].
5 [1974] 40 DLR 371 (Can. SC].
6 In *Grayan Ltd* [1995] Ch 241, 257 F-H [CA].
7 In *Grayan Ltd* [1995] Ch 241, 258 [CA].
8 Re *Westmid Packing Ltd* [1998] 2 All ER 124,131 e-f [CA].
9 Re *Barings plc (No. 5)* [1999] 1 BCLC 433, 489 a-c.
10 [1968] 2 All ER 1221, 1227 E-G.
11 [1970] 1 Ch. 199, 210B [CA].
12 [1980] 1 All ER 393, 405 d [CA].
13 [1988] 2 MLJ 449, 462 D-F [SC].
14 Mohd. Radzuan bin Abdul Halim, the Edge, 13th December 1999.
15 Associate Professor of International Business, Director of the Southeast Asia Business Program, University of Michigan Business School on "Malaysia's Response to the Asian Financial Crisis" during her testimony to the Subcommittee on Asia and the Pacific Committee on International Relations, U.S. House of Representatives, Washington DC, USA on June 16, 1999.
15 Prema-Chandra Athukorala, "----------", in *East Asia in Crisis*, edited by Ross McLeod and Ross Garnaut, Routledge, London, 1998, p. 85, et seq.
16 The severity of the crises in Thailand, Indonesia and South Korea was such that IMF funding to the three countries in 1997-98 totaled US$120 billion, the highest in its history.
17 *Asia in Crisis: The Implosion of the Banking and Finance Systems*, John Wiley & Sons (1998), pp. 2 and 3.
18 Chairman, Securities and Futures Commission, Hong Kong and former Adviser to Bank Negara Malaysia – in a paper entitled "Global Financial Crisis: Implications for Financial Regulation" and published in *Ekonomika*, Newsletter of Persatuan Ekonomi Malaysia, July 1999.
19 President of the Malaysian Economic Association and Director of Finance, Genting Berhad, in a paper entitled "The Current Malaysian Banking & Debt Crisis and the Way Forward" presented at ADB/World Bank Senior Policy Seminar, Manila, Philippines on 10th March 1998.
20 Chairman Federal Reserve Board, United States at the "Financial Crisis Conference", Council on Foreign Relations, New York, United States on 12th July 2000.
21 Statistics provided by Tan Sri Ali Abul Hassan, the Governor of Bank Negara Malaysia, in a speech delivered on 15th March 2000 at Bank Negara and published in *Insaf* (2000), 29(1), p. 7.
22 See note 15 infra. p. 98.
23 *The Return of Depression Economics*, Penguin (2000), pp. 67, 88 and 89.
24 In a speech entitled "State of the Malaysian nation – Preserving Unity, Strengthening the Economy and Managing Growth" delivered on 28th August 2000, Kuala Lumpur.
25 *Asian Wall Street Journal*, 25th October 2000. Also see another previous article in the same journal, published on 19th January 1998.
26 See an informative article about Perwaja's problems in the *Asian Wall Street Journal*, 12th June 2000.
27 See also Appendix 2 hereto.
27 Quoted in the *Financial Times*, 15th August 2000.
28 In a paper entitled "Financial & Corporate Structuring in Malaysia" published in *Ekonomika*, Bulletin of Persatuan Ekonomi Malaysia, April 2000.
29 See p. 146 of *Asia in Crisis: The Implosion of the Banking and Finance Systems*. John Wiley & Sons [1998].
30 A model was built giving various weightings to each and every financial detail expected from annual reports. Each column of Table 1 gives scores to banks against a maximum possible score in respect of one major disclosure category. The model adjusts for the absence of information on types of transactions some banks do not enter into. It gives subjective weighting according to the relevance of each type of information. Applied to North American banks, the model usually gives scores in a range of 900 to 970 out of a perfect 1000.
31 Chairman, Securities and Futures Commission, Hong Kong and former Adviser to Bank Negara Malaysia – in a paper entitled "Global Financial Crisis: Implications for Financial Regulation" published in *Ekonomika*, Newsletter of Persatuan Ekonomi Malaysia, July 1999.

[32] President of the Malaysian Institute of Corporate Governance (MICG) and the Federation of Public Listed Companies (FPLC). Datuk Megat is probably the best known proponent and public face of good corporate governance in Malaysia. Considering his experience in the corporate world and his leadership of MICG and FPLC, his views carry considerable weight

[33] *New Straits Times*, 24th May 2000.

[34] *Business Times*, 10th July 2000.

[35] Regional economist at ABN AMRO Bank. Quoted in Asian Economic survey – Economic Reports (Malaysia), *Asian Wall Street Journal*, 23rd October 2000.

[36] Statistics from the *Financial Times*, 15th August 2000. Also see Appendix 3.

[37] Managing Director of SG Securities (Singapore) Pte Ltd, *New Sunday Times*, 29th October 2000.

[38] *Asian Wall Street Journal*, 23rd May 2000.

[39] *Asian Wall Street Journal*, 25th October 2000 and 1st November 2000; *Asiaweek*, 3rd November 2000.

[40] Eve Winkler, Manager of Equity Content at Standard & Poors, Singapore, *Asian Wall Street Journal*, 31st October 2000.

[41] "Last of the Corporate Statemen", *The Corporate Board*, May-June 1997.

[42] For instance, the speech by Datuk Ali Abdul Kadir, Chairman, Securities Commission entitled "Corporate Governance Trends in Malaysia", 20th August 1999, Kuala Lumpur.

[43] For instance, the acute analysis by Mohd. Redzuan bin Halim, *The Edge*, 13th December 1999.

[44] See Appendix 2 hereto.

[45] In a speech entitled, "The State of the Malaysian Nation – Preserving Unity, Strengthening the Economy and Managing Growth", 28th August 2000, Kuala Lumpur.