CHAPTER 1: INTRODUCTION

1.1 Background of Study

The Malaysian economy was growing at an average of 7% annually until 1997. When the economic crisis hit the nation in 1997 the country had a negative growth of 2%. The regional financial crisis, global recession and weaknesses in Malaysian economic planning led to collapse of the capital market and withdrawal of foreign investments. During this time corporate Malaysia stood accused of improper conduct. The main cause of the crisis may have been the currency turmoil, which hit the region, but Malaysia could not sustain the impact of the turmoil as well as Singapore. Why? The excesses committed by some unscrupulous directors who did not act honestly and responsibly during the boom times exacerbated the problem. There have been numerous examples of abuses for it was true that many directors of listed companies abused their privileged positions during the good times.

In March 1998 The Ministry of Finance announced the establishment of The Finance Committee on Corporate Governance (FCCG), which would look into establishing a framework for corporate governance and setting best practices for the industry. This initiative was propelled with a hope that enhanced standards of corporate governance are somehow necessary in restoring investors' confidence in the Malaysian market.

The FCCG examined several international best practices benchmarks in order to formulate corporate governance principles and recommend those practices, which will eventually be modified to suit the local environment. The review was completed and submitted to the Ministry of Finance on 8th February 1999 with an accompanying Malaysian Code of Corporate Governance. On 1st June 2000 The Kuala Lumpur Stock Exchange (KLSE) mandated the inclusion of a corporate governance statement in the annual reports of all listed companies.

The Report on Corporate Governance adopts the following definition of corporate governance:

> *"Corporate governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders."*

1.2 Problem Statement

The Malaysian Code of Corporate Governance has been in existence for over four years now. But one often wonders as to its usefulness and effectiveness in changing the local corporate landscape. Is it just a collection of wishful concepts, which will not go beyond the realms of lip service? This study intends to determine whether mandating the inclusion of a corporate governance statement into the annual reports of listed company did bring about the necessary change to induce companies to move towards the disclosure based regime. Thus this paper intends to fill up two gaps as noted above in the local accounting literature by examining as to whether mandating the inclusion of corporate governance requirements has brought about much effects as earlier mentioned. Secondly the paper will also attempt to identify several corporate governance determinants for corporate voluntary disclosure in Malaysia.

1.3 Purpose and Significance of Study

This paper has two objectives. The *first objective* is to examine if there is any significant change in the level of disclosure in corporate annual reports by companies listed on the KLSE before and after corporate governance requirements were made mandatory in 2000. The *second objective* is to understand further the possible explanators for corporate voluntary disclosures in annual reports in Malaysia.

1.4 Research Questions

This study intends to answer the following research questions: -

1. Is there any significant change in the level of voluntary disclosure in corporate annual reports by companies listed on the KLSE before and after corporate governance requirements were made mandatory in 2000?
2. Will companies with higher proportion of independent non-executive directors be more likely to have a higher extent of voluntary disclosure?
3. Will companies with chairpersons who are also CEOs be less likely to have a higher extent of voluntary disclosure?
4. Will companies with family members on board be less likely to have a higher extent of voluntary disclosure?

1.5 Scope and Limitations of Study

This study uses secondary data collected from the annual reports of companies listed on the KLSE Main Board during the years 1998 and 2002. 1998 is chosen as a basis of comparison because the KLSE composite index was at it's lowest during this time. If the composite index is reflective of investors' confidence then it is appropriate to gauge the level of voluntary disclosure this year. 2002 is chosen next. 2001 was not considered since any implementation of ruling always requires some time for companies to adjust and as such 2002 seemed appropriate.

A sample of 30 companies was selected from the top (ranked by sales/turnover) 500 public listed companies as at September 2002. As a result a total of 60 annual reports are reviewed in the analysis. Companies from the finance and trust sectors are excluded due to the specialized nature of business. This is so as this industry is subjected to different regulations and disclosure requirements as compared to others. Companies listed on the second board were also eliminated since the companies listed on the main board represent the better-established firms.

1.6 Organization of the study

This study is divided into five chapters.

- Chapter 1 will cover the background of the research, purpose and significance of the study, research questions, scope of the study, limitation of the study and organization of the study.

- Chapter 2 will cover previous studies on the subject matter. The chapter is divided into five parts. After a brief introduction the chapter proceeds with the part on corporate governance and its link to the Malaysian corporate performance. This is followed by the evolution of the Malaysian Code of Corporate Governance and studies pertaining to disclosure and the development of disclosure index. This chapter ends with the determinants of corporate voluntary disclosure and a brief conclusion.

- Chapter 3 will cover the description on the sample selection, items in the disclosure check list, method employed to measure the total disclosure score and lastly statistical methods to verify the results.

- Chapter 4 presents an analysis of the findings and the results obtained.

- Chapter 5 provides a conclusion and a summary of the research findings. The suggestions for future research and implications of the research are presented at the end of the chapter.