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SOME LEGAL ASPECTS OF ENTERPRISE FINANCING

by

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Fakulti Undang-Undang,
Universiti Malaya

Oktober, 1975.

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Tee Hong Geok.

C O N T E N T S

LIST OF CASES

1. Ashbury Railway Carriage and Iron Company v Riche (1875) LR 7 HL 653
2. Charterbridge Corporation Ltd v Lloyds Bank Ltd [1969] 2 All ER 1185
3. Bell Houses, Ltd v City Wall Properties, Ltd [1966] 2 All ER 674
4. Irvine v The Union Bank of Australia (1877) 2 A.C. 366
5. Holmes v Keyes [1957] 2 All ER 129
6. Rayfield v Hands [1960] CH 1
7. Greenhalgh v Ardene Cinemas Ltd [1930] 2 All ER 1120
8. Tamlin v Hannaford [1950] 1 K.B. 18

SOME LEGAL ASPECTS OF ENTERPRISE FINANCING

Objects of the Paper

The motives and objects of doing a paper on the legal aspects of enterprise financing [1] is to make a thorough study of all the methods of financing which are available under our present legal structure to enterprises, both companies in the public and private sectors as well as statutory corporations. It is intended to make an analysis of the use and availability of such financing with a view to ascertaining whether the legal structure provides a good and solid foundation or basis in enhancing economic development, especially as propounded under the New Economic Policy.

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[1] In this study, the more commonly-used word "company" has been abandoned in favour of the word enterprise. This distinction has been made because of the meaning of the word 'enterprise' which includes registered companies under the Companies Act both public and private, government-owned companies, and, most important of all, statutory corporations established under separate Acts of Parliament. Such statutory corporations would not be covered by the word "company", hence the preference for the word 'enterprise'.

The aims of the Government are reflected in the foreward to the Second Malaysia Plan where Tun Abdul Razak, the Prime Minister of Malaysia is quoted as saying :

> ".....The Plan is a blueprint for the New Economic Policy. It incorporates the two-pronged objectives of eradicating poverty, irrespective of race, and restructuring Malaysian society to reduce and eventually eliminate the identification of race with economic function. In order to achieve this objective, the Plan contains new strategies, priorities and programmes. In particular, it is intended that there should be more active and direct participation in commerce and industry, so as to make a meaningful contribution towards the attainment of the economic and social goals. " [2]

Keeping in mind the objects of the Government as expressed by Tun Razak and quoted above, to what extent are the present methods of financing in this country effective ? For instance, how good or useful are present financing methods for securing debts ? Are there any differences in the methods of financing between private companies and statutory corporations ? Can anything be done by the Government to aid enterprises, whilst in the process enhancing the economic and social development of the country ?

Under the New Economic Policy, it is noted with interest that the Government is to assume "an expanded and more positive role" in the economy than it has done in the past. The Government will participate more directly in the establishment and operation of a

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[2] Second Malaysia Plan, 1971-1975 page v

wide range of productive enterprises. This will be done through wholly owned subsidiaries as well as joint ventures with the private sector. It is noted that direct participation by the Government in commercial and industrial undertakings represent a significant departure from past practice. The necessity for such efforts by the Government arises partly from the aims of establishing new industrial activities in 'selected new growth areas' and of creating a Malay commercial and industrial community. [3]

The role of the Government in its efforts to participate will include direct construction of business premises, direct investment in productive and commercial enterprises to be controlled and managed by Malays and other indigenous people, the promotion of in-service training programmes and a variety of other activities covering financial and technical assistance. Financially, the Government can give valuable assistance in the form of loans, funds, allocations and guarantees. [4]

The largest item of government financing of private investment is in the land development programmes, such as FELDA and other government agencies. The Government's financing of perennial crop investment is estimated to be $437 million under the Second Malaysia Plan.

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[3] Second Malaysia Plan, 1971-1975 page 7

[4] Ibid. page 8

Government financing of private investment in commercial activities and manufacturing will be done through its contributions to PERNAS, MARA, MIDF and SEDC's. Projects for these agencies under the Second Malaysia Plan, which includes joint-ventures with private interests indicate that Government's contribution will add at least $230 million to those agencies.

The basic question remains: Is the present form of financing adequate? Even with increased government participation and help in financing necessary and essential projects, are the present methods of financing adequate and effective?

The Government has recognised the problems and difficulties attached to financing in this country. It has taken positive steps which, though greatly helpful in certain aspects (such as relates to statutory bodies and quasi-governmental enterprises) but it is also insufficient with regard to many other private and public enterprises which still face a multitude of serious financing problems.

Thus, in view of the growing need for commerce and industry in this country, the financing of enterprises becomes a key issue. In this study, it is intended to take a look at the existing methods of financing in Malaysia and to conduct an investigation as to whether there are any shortcomings. If it is found that present methods of financing are inadequate, then it is proposed to discuss any positive reforms which might help to create a more healthy and encouraging climate for the growth of enterprises in this country.

Historical Background of Company Law

This part which deals with the historical background of company law, together with the next part of this paper, which relates briefly to the historical background of statutory corporations have been inserted to obtain a clearer picture of the growth of enterprises as a whole. To know the present and future, it is imperative to study the past. Furthermore, a look at history is a step towards realising and understanding the basic aims and intentions of the legislature in the framing and passing of statutes and laws relevant to our study, as well as the basic reasons for the rise and importance of statutory corporations today.

Company law in this country is governed directly by the Companies Act, 1965. [5] It has been evolved through a long and complicated process of change and revision which began with the Companies Consolidation Act of 1908. This was made in 1915 and was not revised until 1923, in which year the Companies Ordinance, 1923 came into being. English Company Law was revised and consolidated in 1929 but at that time, many of the important amendments introduced by that Act were not adopted in the Colony. With a view to bringing the local law in line with that of England, the Registrar of Companies, Singapore, prepared, during 1936, the first draft of a Bill based on the Companies Act of 1929.

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[5] The Companies Act, 1965 was revised in 1973.

In January of 1937, the Colonial Secretary appointed a committee to consider and advise as to the amendments to be made to that Bill and to draft the Rules, Regulations and Scales of Fees to be made under the new law. The Committee commenced work and in May 1938, the Attorney-General informed the Government that similar legislation was contemplated in the Federated Malay States and suggested that a joint-committee might be appointed with a view to uniformity of legislation.

The Committee did not advise the formation of a joint-committee for the Colony and the Federated Malay States at that stage. They considered it impracticable for a joint-body to deal with matters and questions of drafting. Copies of the draft bill were supplied to the Federated Malay States and it was recommended that the two committees should continue their work, keeping in touch with one another as far as possible.

The Committee framed the following opinion on the question of uniformity of Company Law in the Colony and the Federated Malay States:

> " Many companies have property in both the colony and the Federated Malay States .... Many agency houses and firms of secretaries and auditors have branches in both places and members of their senior staffs are frequently transferred from one to the other. The Judges of the High Court are interchangeable and the Courts of Appeal are virtually one.
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> All these facts make it desirable that the legislation relating to companies should be uniform so that the public may know what their rights are and what degree of control they will have over the companies in which they invest and

so that those concerned with the floatation and management of companies may be clear as to their duties and liabilities.

Uniformity in every detail is not even theoretically possible, ... Subject to these differences, however, the text of the two statutes should be identical. " [6]

Amendments were made to sections 2 & 3 in 1937 and to section 4 in 1938. In 1940, a major change came about. The existing law relating to companies was amended and enacted in the Companies Ordinance 1940 which came into force on 1st July 1941. This Straits Settlements Ordinance No. 49 of 1940 was extended throughout Malaya by the Malayan Union Ordinance No. 13 of 1946.

In 1965, a new Companies Act was enacted to consolidate and amend the law relating to companies in Malaysia. It was passed by Parliament and received the Royal Assent on November 5th, 1965. It came into force on 15th April 1966.

It is this Act which applies throughout Malaysia and governs all matters relating to companies.

Historical Background of Statutory Corporations.

As far as the historical development of statutory corporations is concerned, the earliest forms of statutory corporations were established to provide an essential service or utility, for example,

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6 Straits Settlements, The Companies Bill, 1939.
Report of the Companies Legislation Committee page viii.

the Electricity Board. (our present L.L.N. - Lembaga Letrik Negara) But at that time, the use of such public enterprises to enhance economic development was not appreciated. Thus it was not used to any great extent.

In fact it was only in 1953 when the Rural Industrial Development Authority (RISDA) was set up that statutory corporations derived some measure of importance. This was soon followed by the Federal Land Development Authority (FELDA) in 1956. FELDA was established for the express purpose of implementing large scale land development and settlement projects. In fact, at the present time, FELDA is the most important institution for fulfilling the Government objectives of developing the basic infrastructure of the country. [7]

But even then, the establishment of statutory corporations was not seen as a method of promoting the economic and social development of the country but merely as a means for providing development in certain much-needed areas.

However, after independence, matters started to speed up. The Government saw the possibilities of employing statutory corporations as a means of development. In the agricultural sector, the Federal Agricultural Marketing Authority (FAMA) [8] played an important part.

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[7] Jaginder Singh, Public Enterprises and their Legal Structure in Malaysia. [1975] JMCL 1

[8] FAMA was established in 1965. It was entrusted with the function of promoting agricultural marketing efficiency, of co-ordinating activities in respect of the marketing of agricultural produce through collaboration with persons or organisations engaging in agricultural marketing.

The Malaysian Agricultural Research Development Institute (MARDI) [9] was established for the purpose of doing research in livestock, freshwater fisheries and crops, except rubber. [10]

Other statutory corporations were established to promote Bumiputra participation in business, for example, the Majlis Amanah Rakyat (MARA) and the National Corporation Berhad or Perbadanan Nasional. (PERNAS) [11]

From here we can draw the premise that statutory corporations were formed to fulfill government objectives and to carry out its national policies. Once the pace is set, it is reasonable to presume that the Government will continue to encourage the setting up of more statutory corporations to further promote the economic, social and industrial development of the country.

Research Methodology

No single research methodology is sufficient in itself to provide all the necessary materials and data required to write this paper. Therefore, in addition to the usual sources of materials, (such as law reports, statutes, parliamentary proceedings, textbooks, reports, proposals and targets of policies published by the

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[9] Established in October 1969.

[10] Rubber continues to be the responsibility of the Rubber Research Institute.

[11] PERNAS was incorporated as a private company in 1969 to promote increased participation of the indigenous community in commerce and industry.

Government for example, the Second Malaysia Plan & the Mid-Term Review of the Second Malaysia Plan) information has also been gathered by means of surveys, interviews and research into the financial structure of a number of enterprises.

Special attention has been paid to the role of the Government in enterprise financing. To what extent are they directly or indirectly active? In which sector do their assistance predominate?

An important question that remains is as to what criteria were employed in the selection of those enterprises in which detailed studies have been made. As will be observed by a careful examination of Appendix 1, the institutions chosen cover a wide, and it is hoped, a complete cross-section of enterprises which carry on activities in this country. In addition, an important factor for their being chosen is the fact that as far as possible, it is sought to choose enterprises which are of some standing in the national enterprise community.

As a rough guide, it may be stated that data has been gathered from banks (which provide a substantial amount of financing) from private companies (to see how they obtain their capital) and from government set-up statutory corporations. It is hoped that such a wide cross-section will result in the gathering of sufficient data which will present a comprehensive and realistic picture of the entire situation.

CHAPTER I

STRUCTURE OF A COMPANY

(i) Public and Private Companies

A company is in law a different person altogether from the members. It has often been described as a separate legal entity. Companies can be divided into two chief types: public companies and private companies. [12]

A public company is defined in Palmer's Company Law as "a company which is not a private company". [13] Its articles do not contain provisions restricting the number of its members or excluding generally the offer or transfer of its shares or debentures to the public. The general rule is that any member of the public willing to pay the price can purchase shares in a company. But this is not strictly true. In many instances, for example where a public company has several classes of shares, the Articles may contain restrictions on the issue or transfer of shares belonging to one or many of these classes. A close look at the Articles and the Memorandum are therefore essential for the determination of the question of free transferability of shares. Thus it is NOT true that a public company must allow dealings in its shares.

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12 For the different types of companies, see Section 14 of the Companies Act.

13 Palmer's Company Law, 21st Edition by C.M. Schmitthoff & J.H. Thompson, 1968 , page 33.

The shares of public companies are capable of being dealt with on the Stock Exchange. It is not all public companies that are so dealt with but only those that are registered with the Stock Exchange. There are special fixed requirements for quotation of shares on the Stock Exchange.

This discussion on the transferability of shares bears some significant importance when we consider the question of financing and the raising of capital at a subsequent stage. At this early stage, it suffices to say that the question whether shares are freely transferable or not could be a factor in a decision of a bank or other lending institution whether or not to authorize the loan when shares form the security.

The modern private company serves two purposes: first, to enable those carrying on a family business to avail themselves of the advantages of corporate trading, and, secondly, where used as a subsidiary in a group of companies, to avoid the strict requirements obligatory for companies in the private sector. The second reason, though true in many other countries, is not strictly true in Malaysia due to the fact that there is hardly any difference in requirements between public and private companies. Although these two purposes differ greatly, one feature common to all private companies is that members of the public cannot acquire shares in the private company at will.

Also to be noted is the fact that shares and debentures of a private company cannot be dealt with on the Stock Exchange.

This fact brings to mind a number of interesting points. A company quoted on the Stock Exchange carries with it a not insignificant status or standing in the eyes of the rest of the commercial world, including the sources of financing. A public company can apply to be quoted on the Stock Exchange, that is, if it fulfills certain special requirements (as has been discussed earlier). But since a private company is incapable of being so quoted, it does not possess this additional status with which to impress financers. This could in turn jeopardize its chances of negotiating considerable-sized loans without the necessary securities.

The structure of companies is regulated by the various provisions of the Companies Act. [14] A distinction can also be drawn between companies limited by shares [15], companies limited by guarantees [16], companies limited by shares and guarantees [17] and unlimited companies. [18]

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[14] Examples are section 15(1) which deals with private companies, section 27(1) & (2) which is a provision dealing with default in complying with requirements as to private companies.

[15] Section 14(2) of the M.C.A.

[16] Section 14(2)(b)

[17] Section 14(2)(c)

[18] Section 14(2)(d)

Section 14(1) of the Companies Act states how a company is to be formed. It should be noted that the constitution of the company is contained in two documents, the Memorandum of Association and the Articles of Association. In introducing provisions governing these two documents, the legislature contemplated that the former should contain the fundamental law of the company and should be unalterable in the interests of the shareholders, particularly those in the minority, and the public, especially the creditors of the company, whilst the latter should be freely alterable by the shareholders in general meeting.

(ii) The Memorandum of Association

The Memorandum of Association must contain [19] the name of the company, the amount of share capital (if any) that it proposes to be registered with and the division into shares of a fixed amount, the manner in which the liability of the members are limited and the full names, addresses and occupations of subscribers. It deals with two matters, the objects and purposes of the company for which it was formed and the powers of the company for attaining the objects and purposes.

The Memorandum of Association is often a very cumbersome document, the objects of the company being expressed within at great length. The company cannot do anything outside the objects

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[19] As provided by section 18 of the M.C.A.

given in the memorandum. Anything so done is ultra vires. If an act is done by a Director which is ultra vires the company, it is void and the company cannot make it valid even if every member assents to it. [20]

The doctrine of ultra vires came into being because with the passing of years, a feeling grew up that the unlimited and unrestricted powers of directors ought to be curtailed or construed in such a manner that investors and creditors were protected. Investors were considered to need protection against wrongful application of the assets of the company to ventures not in the contemplation of the founders and creditors were expected to be protected against wrongful utilisation of assets which might result in insolvency of a company and a position when creditors could not be paid. A direct result of the growth of this feeling was development of a theory that if the directors seek to enter into forbidden or unauthorized transactions they can be restrained by an action of a shareholder and that a contract for an unauthorised purpose could be regarded as ultra vires and unenforceable as against the company.

The ultra vires rule, insofar as it deals with the memorandum is concerned with acts and contracts beyond the statutory powers and objects of the company as stated in the memorandum.

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[20] This rule was established in the case of Ashbury Railway Carriage and Iron Company v Riche (1875) LR 7HL 653 and it was meant to protect future shareholders and the public at large who deal with the company. But if the Act had been ultra vires the directors only, the shareholders could have ratified it. Or if it had been ultra vires the articles, the company could have altered the articles in the appropriate manner.

The powers in the memorandum must not, however be construed strictly and the company may do anything which is fairly incidental to the powers specified. Powers not expressly mentioned in the memorandum may be implied if they are warranted by the constitution of the company.

The law, however, is in an unsettled state where there is an express power in the memorandum entitling the company to enter into a particular transaction. [21]

Where a memorandum provides that a company is entitled " to carry on any other trade or business which can, in the opinion of the Board of Directors be advantageously carried on by the company in connection with or ancilliary to the general business of the company " [22] the carrying on of an additional business is ultra vires the company if the directors honestly form the opinion to this effect.

The powers of a company are generally expressed in very wide terms because it is inconvenient for a company, or those dealing with it, to be in doubt as to the powers which the company has.

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21 It has been recently held in the case of Charterbridge Corp.Ltd v Lloyds Bank Ltd [1969] 2 All ER 1185 that the state of mind of the directors as to whether the transaction is for the benefit of the company is immaterial.

22 Bell Houses, Ltd v City Wall Properties, Ltd [1966] 2 All ER 674 Per Salmon, LJ.

Nowadays, the Memorandum of Association is usually framed so as to state all the possible things that a company may wish to do as independent main objects of the company, and if this is clearly the intention of the document, the courts will construe it in this manner.

The memorandum is a public document open for all to inspect. Thus, as far as financing is concerned, the Memorandum of Association will be the important document to look in instances where sources of financing is sought. From the memorandum, the limits on borrowing and other related matters can be studied.

At this juncture, we may make a note of Section 20 of the Companies Act. Although in our section 20, provision is made whereby no act of a company is to be invalid only by the fact that the company was without capacity or power, but it must be noted that section 20(1) does not apply to all acts. A distinction is drawn between acts already executed and situations where the contract is not yet performed. Section 20(2) lists the instances when lack of capacity or power may be relied upon. In such instances, proceedings may be instituted by members or debentureholders to restrain the doing of any ultra vires acts. The point to note is that section 20 does not invalidate the application of the principles as enunciated in cases like Charterbridge Corporation, but that it is merely an elaboration and clarification of the principles already established.

By section 28 of the Malaysian Companies Act, a company may, by special resolution, alter the provisions of its memorandum with respect to the objects of the company, but it must comply with sub-sections 2 and 3 which deals with the giving of 21 days' written

notice which is to be given to all members and to all trustees for debenture-holders.

(iii) The Articles of Association

Section 29 of the Malaysian Companies Act deals with the Articles of Association. These contain the internal regulations for the management of the affairs of the company and the conduct of its business.

The Articles of a company are subordinate to and controlled by the Memorandum of Association, which is the dominant instrument. The memorandum contains the conditions upon which the company is granted incorporation, conditions which are fundamental, but some of which is alterable by the correct procedure. The articles are the internal regulations of the company and over these the members have full control, and they may later alter them from time to time as they think fit.

But as far as this paper is concerned, the most important aspect of the articles is the effect of a breach thereof. What happens when an act is done in breach of the articles by the company? Or more specifically, what happens when an agent of the company negotiates a loan on behalf of the company and eventually it turns out that it was in breach of the articles.

A very important case to consider here is that of :

Irvine v The Union Bank of Australia [1877] 2 AC 366

Here the articles of the company provide that the directors should

not borrow more than half the paid up capital of the company. Apparantly, one of the company directors borrowed much in excess of the paid up capital. Part of this excess was subsequently ratified but a sum of £5000 was never ratified.

It was held by the Privy Council that the unauthorized borrowing of £5000 (which was unratified) was not enforceable as against the company.

This case thus expresses and illustrates the importance of a close examination of the articles before any steps for the granting of loans and related matters are considered. It illustrates the great danger of being unable to enforce a repayment of a loan. Thus, the importance of a careful study of the articles should never be under-rated.

The Articles cannot give powers which are not given by the memorandum. But for purposes of construction, on points which need not necessarily be put in the memorandum, they are to be read together and the articles may then explain or amplify the memorandum.

The Articles of Association of the company " should be regarded as a business document and should be so construed as to give them business efficacy, where a construction tending to that result is admissable on the language of the article, in preference to a result which would or might prove unworkable. " [23]

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23 Holmes v Keyes [1957] 2 All ER 129 at page 138 Per Jenkins, LJ.

The articles bind the company and the members thereof to the same extent as if they had been signed and sealed by each member and contained covenants by each member to observe them. Accordingly, each member is bound to the company (and vice versa). But the articles only form a contract between the company and its members in respect of their ordinary rights as members and not in any other capacity.

Each member is also bound to the other members. Where the articles of a private company provided that " every member who intends to transfer shares shall inform the directors who will take the said shares equally between them at fair value ...." [24] it was held that the directors were bound to buy them from any member who wished to transfer them.

Another noteworthy fact is that the company is not bound to a third party. But the court may imply a contract in the terms of the articles.

Section 31 of the Companies Act provides that a company may by special resolution alter or add to its articles. Therefore by an alteration, the company can give itself the additional power to do certain acts , for example, the borrowing of larger amounts of money. A company cannot deprive itself of its powers to alter its regulations. But a provision in an article as to voting rights which has the effect of making a special resolution incapable of being passed if a particular shareholder exercised his voting rights is not such a provision.

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[24] Rayfield v Hands [1960] Ch 1

But a company cannot by altering its articles justify a breach of contract with third parties, that is, a company cannot avoid its liabilities under a contract made with persons who are not members of the company by altering its articles.

A resolution passed by the requisite majority of shareholders will bind the majority provided that it is passed bona fide for the benefit of the company as a whole. This does not mean that " the shareholder must proceed on what, in his honest opinion, is for the benefit of the company as a whole." [25] The company as a whole means the corporators as a general body. They too are entitled to consider their personal financial interests.

(iv) The Capital of the Company

The word "capital" is used in company law in various senses, thus there is a necessity to distinguish between

(a) nominal or authorized capital

(b) issued capital

(c) paid-up capital. It is also relevant to refer to

(d) reserve capital

(e) share-premium account

(f) capital redemption account

(g) equity share capital

(h) loan capital and

(i) fixed and current capital.

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25 Greenhalgh v Ardene Cinemas Ltd [1930] 2 All ER 1120 at page 1126 Per Evershed, MR.

Every company limited by shares or limited by guarantees and having a share capital is required to have a nominal capital with which it is registered. It must be stated in the Memorandum of Association. The nominal capital is divided into shares of a fixed amount. It may be increased above, or reduced below the figure stated in the memorandum.

The nominal capital sets the limit of capital available for issue. Accordingly, the issued capital can never exceed its nominal capital. The nominal capital represents only an authority by the shareholders to the directors to create new capital by the issue of shares; the issued capital on the other hand, has actually been taken up by shareholders who have agreed to give consideration in cash or kind for the shares issued to them. The issued capital is thus a reality and not merely an authority.

The size of the issued capital is of great significance with regard to financing. Financers have a healthy regard for the size of a company's issued share-capital in its determination of the amount of the loan to be approved. A larger issued share capital will merit a larger loan.

The issue of shares may be decided upon by the Board of Directors, without recourse to a general meeting, provided the articles of association do not provide otherwise.

The difference between the nominal and the issued capital is known as the unissued capital.

When the nominal capital is issued in whole or in part, each of the persons to whom it is issued becomes liable to pay to the

company the nominal value of the shares taken. The obligation of the shareholder shall be payable on the company making a call on him. The date on which this obligation is discharged is often the date of issue of the shares. The money received on each share as a result of calls is said to be paid up and the total amount that has been paid up on a company's shares is called the paid-up capital.

As long as anything remains uncalled on an issued share, there is an unpaid liability for the balance and the total amount of these liabilities will be regarded as the unpaid capital.

In reality, the paid-up capital represents the amount which the company has in hand with which to finance its various activities. It would not be untrue to say that it represents the company's net worth. Many financing bodies will not give a loan in excess of the company's paid-up capital. This is a realistic outlook and approach and a way to ensure that no unnecessary risks are taken from the point of view of the financers.

A company may resolve by special resolution that a part of or the whole of the uncalled capital shall not be called up except in the event of a winding up. This amount resolved by the company is called the reserve liability. This is provided for by section 56(2) of the Malaysian Companies Act. Banks would normally take the reserve liability into account together with the paid-up capital in order to compute the net worth of the company's assets.

The consideration which a shareholder has to provide in cash or kind for the shares issued to him by the company may not be

equal to the nominal value of those shares. Where the consideration exceed the nominal value, the shares are at a discount. Where shares are issued at a premium, it would be commercially unwise to allow the distribution of the premium as dividend to the shareholders because it could hardly be considered as a profit. Thus section 60 of the Companies Act provides that a figure equivalent to this premium shall be put into an account to be called the share premium account. This account is only to be used for specific purposes, including the issue of bonus shares.

When redeemable preference shares are redeemed out of profits there would, at that time be available a book profit equivalent to the amount of the redeemed capital. In order to prevent the distribution of that profit, the Companies Act requires the company to form a capital redemption reserve fund which thenceforth has to appear on the liabilities side of the balance sheet. This is provided for in section 61(5) of the Companies Act. This fund can be capitalized by the issue of bonus shares. If any other use is intended, the capital redemption procedure applies.

The equity share capital includes the issued share capital except shares limited to a specified amount as regards dividend and capital. The equity share capital of a company thus consists of the whole of the issued, ordinary, deferred and preference capital carrying participating rights; only non-participating preference shares and other shares having limited rights as to capital and dividend do not fall within the term.

Loan Capital denotes the debentures and debenture stock issued by the company. The holders of these securities are creditors of the company, and as such, do not have a contributory interest in the company in the way that a member has.

When a loan is being sought, the Bank or other source of financing concerned will, as a matter of course, look at the loan capital. This will be related in turn to the nominal capital, the paid-up capital and the reserve capital. In this manner, he can compute the amount of liability of the company to the various creditors. Subsequently it would know the wisdom or folly of approving a loan to the company concerned. For instance, if a company is already surviving on loans from various sources while possessing a comparatively small paid-up capital, then it would probably be a bad risk.

Fixed and current assets are frequently referred to in commerce and accountancy as fixed and circulating capital although some disagreement exists as to the limitation of those terms. Naturally, the amount and size of a company's fixed as well as current assets will have a bearing on the financial position of the company and will affect its ability or otherwise of obtaining financing.

(v) The Shareholders, Management and Administration of the Company

A shareholder of a company possesses certain rights and duties. The rights include the right to dividends, the right to vote in

general meeting, the right to receive a proportionate return of the surplus assets of the company after all the other creditors of the company have been paid off in the winding up of the company. Shareholders also possess the right to enforce due observance of the articles [26] and the right to transfer shares in accordance with the articles.

The duty of the shareholder is to pay the amount unpaid on the nominal value of the shares held by them when called upon to do so by the company. Thus it can be said that in the initial stage, it is the shareholders who provide the financing.

The general policy and the management of the company are under the control of the directors. The first directors may be named in the articles or else appointed by the subscribers to the memorandum. The manner in which subsequent appointments of directors are to be made is usually specified in the articles.

Who are the directors? Are they the ordinary men on the Srijaya bus ? The answer is NO. As can be seen, a study of the Board of Directors of any big corporation reads like a Who's Who. It is those with social standing, status, wealth and the like that are chosen or appointed directors. Why is this so ?

From a survey conducted among banks and other lending institutions, in their lending activities, regard is had to the names, position and the social standing of the directors of the

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[26] Section 33 of the M.C.A.

company seeking the loan. The reason for this is manifold. In the first instance, a board of well-known directors inspire confidence in the shareholders as well as the intending shareholders. Secondly, the directors are not infrequently called upon to give personal guarantees for the company's loans. Furthermore, it would not be far wrong to say that a board of capable and enterprising directors would greatly enhance the company's net worth.

A public comapny may, notwithstanding anything in the articles remove a director by ordinary resolution. This is provided by section 128 of the Companies Act. The fact that directors may be removed shows clearly who has the control of the company. "Special Notice" must be given of any resolution to remove a director or to appoint someone in his stead at the meeting in which he is removed. The company, on receiving such notice must send a copy of it to the director concerned and he is entitled to be heard at the meeting.

Usually, one of the directors is appointed as Managing Director. It is provided that " the directors may from time to time appoint one or more of their body to the office of Managing Director for such periods and on such terms as they think fit. " [27] They may also, subject to the agreement, revoke such appointment.

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[27] Article 91, Table A, 4th Schedule of the Companies Act at page 352

The managing director is the most important official of the company. He is the chief executive head and he is the repository of considerable power in the company. Although the managing director as such has no specific powers or duties recognised by law and must derive his powers from either the articles or resolutions of the general meeting or the board of directors, it is generally presumed that the managing director is clothed with the authority to bind the company in respect of its normal day to day affairs.

His remuneration and powers are usually defined by the directors. Thus Article 93 of Table A of the 4th Schedule provides:

> " The Directors may entrust to and confer upon a Managing Director any of the powers exercisable by them upon such terms and conditions and with restrictions as they may think fit, and either collaterally with or to the exclusion of their own powers and may from time to time revoke, withdraw, alter or vary all or any of such powers. " [28]

Usually the Managing Director is appointed under a service contract and accordingly is both a director and an employee of the company. The role played by the managing director in financing should not be overlooked. Frequently, he has to negotiate loans and devise methods of obtaining financing. His decision and activities will determine the direction the company will take.

The powers of Directors are generally set out in the Articles and there is usually a clause giving them powers of management

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[28] Article 93, Table A, 4th Schedule, page 352.

and all the powers of the company which are not otherwise dealt with. The Directors are the only persons who can deal with the matters thus assigned to them and their decision cannot be over-ruled even by a General Meeting of the company unless the Articles are altered by a special resolution or unless the directors are acting in their own interests against the interests of the company. They communicate their policy to the shareholders and are bound to do so even if such policy is attacked by the shareholders.

The shareholders may enlarge the powers of the directors and thus enable them to do anything that the comapny can do. If the directors do some act which is beyond their powers, the shareholders may ratify their act if it is within the powers of the company.

Every company must, in each year, hold a general meeting as its "annual general meeting". Not more than 15 months may elapse between the date of one annual general meeting and the next. But so long as a company holds its first annual general meeting within 18 months after its incorporation, it need not hold it in its first year of incorporation or the following year. The General Meeting plays a significant part in the sense that it can, to a certain extent, decide on the company's future activities and trends. It can decide on the taking of loans when the occassion warrants it. The general body of shareholders can control the exercise of the powers vested by the articles or, if the opportunity arises, under the articles, by refusing to re-elect the directors of whose actions they disapprove.

A final point to note is that the general meeting possesses certain residuary and default powers. If the board is for some reason incapable of or refuses to exercise any of the powers vested in them, the general meeting may exercise such powers under the default powers concept. Secondly, where the articles or the memorandum of association do not vest the powers specifically either in the board of directors or in the general meeting, the general meeting is, under its residuary powers, entitled to exercise all such powers.

(vi) Accounts.

A company is under a duty to keep books of accounts. These must be sufficient to give a true and fair view of the state of the companies' affairs and to explain its transactions. The accounts should be kept in a manner which prudent business people would adopt. [29] The company must also present a balance sheet, a profit and loss account, group accounts (where necessary) the auditors' reports and the Directors' Report. There are serious penalties for falsifying accounts. [30]

The Directors must, in every year, lay before the company in general meeting a balance sheet. This is intended to show the state of the company's affairs at a given time. If any director fails to comply,or to take reasonable steps to comply with the requirements

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[29] Section 167(1) of the Companies Act.

[30] Ibid. Section 167(6).

as to the keeping of proper books of accounts and balance sheets or by his own wilful act has been the cause of any default by the company, he is guilty of an offence [31] and may be liable to a penalty of imprisonment for two years or $5000.

It is a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the provisions of the Companies Act were complied with and that that person was in a position to discharge that duty. [32]

This brief discussion on accounts is relevant to show that the party providing finance can look at the books of accounts of the company to know its true financial situation. The authenticity of the nature of the company's affairs would be vouched for. In this aspect then, the provisions of the Companies Act is extremely important and helpful in that it demands the keeping of proper books of accounts, failure to do which would result in severe penalties.

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[31] Section 171(1) of the Companies Act.

[32] Ibid. Section 171(2).

CHAPTER II

STRUCTURE OF A STATUTORY CORPORATION

A new feature in the corporate world is the statutory corporation. They may assume many different forms. Sometimes it is a full and complete artificial person like any other company but sometimes it is a mere extension of the government under a cloak of separate personality. Most often, it is a commercial corporation designed to run an industry or public utility, for example, railways, airlines, waterworks and electric companies. Such statutory corporations are incorporated by special Act of Parliament.

The purpose of taking a look at the structure of statutory corporations is to enable us to compare its structure with that of ordinary registered companies. We will then be able to note and to discuss the significance of these differences. After that, at a later stage, it will provide the basic background for comparing different modes of financing and the different problems (if any) encountered by each.

A statutory corporation has no Memorandum or Articles of Association. The subject matter of these two documents are contained in the special Act itself. To know more about the structure of statutory corporations, it is proposed to examine the specified Acts of Parliament which set up two such corporations, namely, the Majlis Amanah Ra'ayat Act, 1966 and the Federal Industrial Development Authority (Incorporation) Act, 1965.

The name is set out in the Act and can only be changed by Act of Parliament. Section 3(1) of the Majlis Amanah Ra'ayat Act, 1966, which was gazetted on 1st March 1966, sets up the body corporate in the following words:

> " There is hereby established a body corporate by the name of 'the Majlis Amanah Ra'ayat' with perpetual succession and a common seal and may sue and be sued in its name and ... may enter into contracts ..... " [33] and may acquire property and dispose of it.

The officers of the Majlis are also provided by the Act. Section 3(3) provides that the Majlis shall consist of a Chairman, a member each from the Ministry to be charged with the responsibility of Finance, Commerce, and Industry, Agriculture and Co-operatives, two members to be charged with the responsibility of National and Rural Development, seven members having experience or knowledge in commerce, finance or industry and four other members.

The appointment and determination of officers is determined by the Minister. But, as in ordinary registered companies, it is normally individuals with some social standing and importance that are appointed directors. The duties and powers of each statutory corporation is provided by the Act itself. To see this more clearly, it is expedient to look at section 6 of the Majlis Amanah Ra'ayat Act which provides:

> " It shall be the duty of the Majlis to promote, stimulate, facilitate and undertake economic and social development in the Federation and more particularly, in the rural areas. "

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33 Acts of Parliament 1966. The Majlis Amanah Ra'ayat Act, 1966. Section 3(1) at page 204.

The powers are contained in section 6(2) and this includes the power to carry on all activities, particularly the development of commercial and industrial enterprises, the carrying on of which appears to be requisite, advantageous or convenient for or in connection with the discharge of its duties, including the manufacturing, assembling, processing, packing, grading and marketing of products, research and training.

Its powers include promoting the carrying on of any activities by other bodies or persons for the purpose of establishing or expanding other bodies to carry on any such activities, either under the control of the Majlis or independently, and to give assistance to such bodies which appear to the Majlis to have facilities for the carrying on of any such activities, including financial assistance by the taking up of shares or loan capital or by loan or otherwise.

Subsection (f) contains the words : " to do all acts which the Majlis considers desirable or expedient." [34] The reason for this subsection is to make the objects and powers so wide that almost every activity can come under it. Hence we will later see how government-backed statutory corporations can, by virtue of their wide powers, form a number of subsidiaries with widely differing aims and objectives.

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[34] Section 6(2)(f) at page 206.

As a further illustration, we can take a look at the Federal Industrial Development Authority (Incorporation) Act, 1965. Section 5 of this Act reads:

> " It shall be the function of the Authority to promote and co-ordinate industrial development in the Federation and to advise the Minister on the Formulation of Policies in respect thereof ... " [35]

and for the purposes stated above, the Authority was empowered to undertake economic feasibility studies of industrial possibilities, to undertake industrial promotion work, to facilitate exchange of information and co-ordination among institutions engaged in or connected with industrial development, recommend policy on industrial site and where it deems fit, undertake the development of such sites, to evaluate applications for pioneer status and in subsection (g) " to do all such matters and things as may be rendered or consequential upon the exercise of its powers or the discharge of its functions under this Act. " [36]

Thus it is noted that in certain respects, the structure of statutory corporations are similar to that of companies. The objects and powers are found in the Act itself and they are so worded as to be as wide as possible.

The capital of the corporation is fixed by the Act of Parliament. It must be divided into shares of the prescribed number and amount and each share must be numbered.

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35 Acts of Parliament, No. 13 of 1965, Federal Industrial Development Act, 1965, Section 5 at page 56.

36 Ibid. Section 5(g)

How do statutory corporations obtain their finance? It will be observed that an important source of finance comes from the government. The two statutory corporations that we are studying reflect this.

The Majlis Amanah Ra'ayat Act provides for the establishment of " the Fund " to be administered and controlled by the Majlis. The Fund consists of :

a) such sums as may be allocated from time to time to the Majlis from loan funds

b) such sums as may be provided from time to time by ..... Parliament

c) all sums from time to time received by or falling of any loan made by the Majlis and the interest payable with respect of any such loan

d) monies earned by the opening of any projects, schemes or enterprises financed from the Fund

e) monies earned or arising from any property, interests, mortgages, charges or debentures acquired by or vested in the Majlis

f) any property, investment, mortgages, charges or debentures acquired by or vested in the Majlis

g) sums borrowed by the Majlis for the purpose of meeting any of its obligations or discharging any of its duties

h) all other sums or property which may in any manner become payable to or vested in the Majlis, especially of any matter incidental to its powers and duties.

Thus the Majlis Amanah Ra'ayat does not obtain its financing from one fixed source but from a number of contributory sources. From its central Fund, it has financed and carried on a number of projects of a widely differing nature. This will be dealt with in greater detail in a subsequent chapter.

The provisions with regard to finance as contained in the Federal Industrial Development Authority (Incorporation) Act, 1965 is, however, more concise. Section 6(1) provides: " the expense of the Authority ..... shall be defrayed out of the Funds of the Authority provided by Parliament. " Thus it is established beyond doubt that it is the Government that finances it.

Are there then any differences between the structure of statutory corporations and that of companies? The most obvious and startling difference is that a statutory corporation has neither shareholders nor share capital. Indeed it is only nominally that it has any members, for these are appointed and removed by the Minister. It has a loan capital; it can issue stock in compensation for the assets acquired. This stock is its liability, but instead of being charged on its assets, like a company's debentures, it is guaranteed by the Treasury. As Denning L.J. said in Tamlin v Hannaford [1950] 1 K.B. 18, C.A. at p. 23 ,

> " The money which the corporation needs is not raised by the issue of shares by the corporation but by borrowing; and its borrowing is not secured by debentures but is guaranteed by the Treasury. If it cannot repay, the loss falls on the Consolidated Fund ....., that is to say on the taxpayer. "

Thus it can be said that the financing of statutory corporations face less problems than other forms of institutions. Their fund is provided for by statute. Furthermore, as will be seen in greater detail in a subsequent part of this paper, it will be noted that by nature of its government support and backing, statutory corporations can perhaps be regarded as the most privileged of all enterprises. Loans and financing, whether from a local source or even from a foreign source are readily available. But this will be discussed in greater detail later. At this juncture it need only be said that in all other aspects, the structure of a statutory corporation differs only in minor aspects from that of companies. They too have a duty to hold annual general meetings, to prepare accounts, balance sheets and auditors' and directors' reports. But they have the advantage of being government backed.

As a final word, it may be mentioned that statutory corporations have been condemned by many believers of free competition. They have said that if the Government wishes to compete with public and private companies, it must do so not in its capacity as Government. This would lend statutory corporations an edge over its competitors and if left unchecked might result in a wealth of government monopolies and the death of free enterprise. Part of this argument deserves merit. But the advantages and the disadvantages of statutory corporations and the question of their continued growth is presently in the process of being balanced against each other.

CHAPTER III

THE ROLE OF SUBSIDIARIES

Subsidiaries are an integral part of modern-day corporations. In present times, it has become a habit to create a pyramid of inter-related companies, each of which is theoretically a separate entity, but in reality they are all part of one concern.

The division of a big multi-facet corporation into a number of distinct and separate entities is not necessarily a bad or improper thing. There are instances where it could prove to be the most economical and convenient arrangement, for example, when the concern carries on a number of separate businesses or when it is desirable to distinguish between the manufacturing and marketing part of the enterprise. There is also the advantage of size or a centralised financial policy which can be obtained without the disadvantage of over-centralisation. Such an arrangement comes about inevitably where one company has gradually expanded its control of an industry by buying up the share capital of existing companies in the same field.

However it is important to note that such an arrangement is one that is intrinsically capable of abuse. Although the legislature has seen fit to pass certain laws which restricts the abuse over the use of subsidiaries, it is still possible for a public company to carry on business through subsidiary operating private companies. But certain requirements must be complied with. There is an obligation to file copies of their annual balance

sheets and profit and loss accounts with the Registrar of Companies so that they are open for public inspection.

As far as financing is concerned, there are distinct disadvantages, as well as advantages. This would depend on the type of enterprise that we are dealing with. As far as subsidiaries of government-backed organisations are concerned, there are many advantages, for instance, the Perbadanan Nasional Berhad (PERNAS) has at present 19 wholly owned subsidiaries and joint ventures.[37] It stands as guarantor for its subsidiaries, for example, PERNAS Insurance Brokers and PERNAS Construction. These subsidiaries are able to obtain loans with great ease, sometimes without having to provide any security whatsoever. Furthermore, where securities are required, they are normally given in the form of government guarantee or the personal guarantees of directors. Thus the importance of government backing is clearly shown.

As has been observed earlier, the use of subsidiaries has its advantages. But as ahs already been said, it is intrinsically has
capable of abuse. Thus where a relationship of holding company and subsidiaries exist, the Companies Act makes a number of provisions qualifying the normal rule that each company constitutes a separate legal entity. The most important of these provisions relates to accounts.

By section 168 and 169 of the Malaysian Companies Act, the

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37 Jaginder Singh, Public Enterprises and their Legal Structure in Malaysia, at page 51, [1975] JMCL

holding company's balance sheet and profit and loss accounts are to be presented in the form of group accounts giving a fair view of the state of the affairs of the group as a whole. The accounts of each subsidiary must show details of its indebtedness to and from all companies in the group. The holding companies' directors must also secure that the financial year of each subsidiary co-incides with the holding company's own financial year. This is of immense importance because as far as creditors, shareholders and banks / financing bodies are concerned, group accounts will enable a more realistic look at the state of the company's finances. If separate accounts were given, it would be easy to camouflage the true nature of the company's finances. If separate accounts were permitted, there would be difficulty in discovering the company's assets and liabilities. Thus, from the point of view of a bank or other lending institution, which must necessarily scrutinise all accounts in order to determine the advisability of approving the loan, group accounts are imperative.

Thus, the Act goes some way towards treating all companies within a group as part of the same entity, recognising the real business unit of inter-locked companies rather than the arbitral legal unit of a single company. However, still more remains to be done. For instance, if a subsidiary were to become insolvent, there would be nothing to prevent the holding company from putting it into liquidation notwithstanding that the group as a whole is still solvent.

On the whole, although the Companies Act does afford some measure of protection to potential and actual shareholders, but

little in the form of protection is given to outside creditors who suffer from the application of the separate legal entity rule.

As a result of this, various diverse problems arises as to the financing of subsidiaries, that is, the subsidiaries of public and private companies, not those of statutory corporations. It is true that one available source of financing would be the parent company. But it is also realistic to admit that the entire capital structure of the subsidiary cannot come solely from the parent or holding company. But when subsidiaries attempt to obtain financing from some external source, they inevitably come face to face with difficulties.

For instance, financers might be reluctant to lend money or to give credit to subsidiaries which are on the verge of insolvency or even to those companies which are not firmly established in the economic sense. They fear difficulties in obtaining repayment at a later stage. This fear is even more apparant when the parent company has also given loans to the subsidiary. Should the subsidiary eventually become insolvent, the parent company might seek to be paid off before other creditors of the company. Because of this, efforts have been made to try and subordinate the claims of the parent company to that of any other creditor should such circumstances arise. But this would lead to gross unfairness in instances where the subsidiary company has obtained a bona fide loan from the parent. The present position is that regard should be had to various other conditions, for instance, the extent of control of the subsidiary by the Board of Directors of the parent company, whether the loan

was a bona fide one and whether the subsidiary was existing by itself or was a mere instrument of the parent company.

Another problem is that investors in securities and shares of a corporation often find their investment under the control of a board of directors of a parent corporation with interests opposed to those of the subsidiary. To get around this problem, the courts have held that the dealings of the parent and its directors with the subsidiary will be subjected to rigorous scrutiny, and where their interests are adverse, they may be under a burden to prove not only the good faith of the transaction but also its fairness. The fiduciary obligation is designed not only for the protection of the minority shareholders but for creditors as well.

In view of the above discussion, the question of the usefulness of subsidiaries is an open one. The many advantages of subsidiaries cannot be denied. But unless the problems which they presently face with regard to financing are solved, the continued existence and growth of subsidiaries will be short-lived.

CHAPTER IV

ENTERPRISES AND THEIR FINANCING

The word "financing" brings to mind a wide range of concepts. It could be financing by means of shares which are floated when the company was formed in order to obtain its capital. This could be initial capital for the purchase of land and machinery. Or it could be capital obtained by the issue of debentures or mortgages or charges over property at a subsequent stage when the company is in further need for capital.

In this part of the paper, it is sought to take a brief look at the different forms and types of financing which are available to enterprises. This will then be linked to the various forms of enterprises, to banks and other lending institutions in order to see how and from where different enterprises obtain their financing.

Shares

A primary source of corporate financing comes from shares. Every company has a certain amount of authorized share capital which consists of one or more types of shares having a stated par value. As a matter of convenience, shares can be divided into preference shares, ordinary shares and special classes. We shall see to what extent each of these types are favoured by investors, the privileges they confer and the advantages of each.

(i) Preference Shares

The distinguishing feature of preference shares is that they confer on the holders some preference over other classes in respect

either of dividend or of repayment of capital or both. Unless the preference shares are made "preferential as to capital" they are paid off equally with the ordinary shares on the winding up of the company. However, if the preference shares are made preferential as to capital, any surplus assets of the company after payment of debts will be applied first in paying off the capital of the preference shares. Thus, this type of preference shares would prove to be the most popular.

The question may arise as to whether the preference shareholders have any further rights in the capital if there is a surplus in the winding up after they and the ordinary shareholders have been paid off. This would depend on the Articles. The onus is on tne preference shareholders to show that on a true construction of the Articles, they are entitled to share in any surplus. The principle which the court applies is that where the Articles set out the rights attached to a going concern or to share in the property of the company in litigation, prima facie the rights so set out are exhaustive.

From this discussion, it can be seen that investors should take the initiative to look into the articles of the company in which they intend to invest. Only by so doing can they ensure that the particular type of preference shares which they propose to take is one that confers a right to share in the surplus.

Preference shares are either cumulative or non-cumulative. Where they are cumulative the profits of the company in any year are not sufficient to pay the fixed dividend on the preference

shares, the deficiency must be made up out of the profits of subsequent years. Preference shares are presumed to be cumulative and ambiguous language in the articles do not make them non-cumulative. This can only be done by express provision or clear, succinct language. Thus cumulative shares have a distinct advantage over non-cumulative shares in that in the years of non-profit, they would be re-imbursed in subsequent profitable years.

Companies, as a rule, cannot pay back the capital subscribed by the shareholders without court sanction. But they can (if provision is made in the Articles) issue preference shares on the terms that they may be redeemed out of profits or out of a fresh issue of shares. But no shares can be so redeemed unless they are fully paid up. [38]

Where shares are so redeemed out of profits, a sum equal to nominal value of the shares redeemed must be transferred to the "capital redemption reserve fund". Sums credited to the fund cannot be paid out to the shareholders as dividend but can only be used to pay up unissued shares to be issued as bonus shares.

Where redeemable preference shares have been issued, every balance sheet must contain a statement specifying what part of the capital consists of such shares and the earliest and latest dates

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38 Section 61(3)(b) of the Companies Act.

on which the company has the power to redeem the shares. This redemption is not to be taken as reducing the amount of the company's share capital.

Thus briefly, it can be said that preference shares are the most popular amongst investors who desire some degree of security and a lesser measure of risk. By investing in preference shares, they will obtain priority in the distribution of profits.

(ii) Ordinary Shares

Ordinary shares constitute the residuary class in which is vested everything after the special rights of other classes have been satisfied. They confer a right to the "equity" in the company and the ordinary shareholders are its proprietors. It is they who bear the lion's share of the risks and they who in good years take the lion's share of the profits. If the company's shares are all of one class, then these are necessarily ordinary shares.

Ordinary shares can be of many different types. They may be divided into separate classes with different voting rights. Again, shares may be of different nominal value. Some may be fully paid and others not. Or shares may be given no right of participation until all others have received a certain return. Such a class is the converse of preference shares and is designated "deferred" or "founders" shares. Provided that the company's regulations are complied with, the company has complete freedom as to the creation of classes and as to the names it gives them. The nature of the

rights attaching to each class is a matter of construction of the terms of issue.

(iii) Special Classes

Although most shares fall into either preference shares or ordinary shares, it is possible that the company would create shares for particular purposes, containing special terms. A good example of this is provided by employees' shares. These are shares created for issue to employees and they are to be transferred to trustees when the holders leave the company's employ. They normally have no vote.

The main weakness of schemes of this sort is that the shares result in co-partnership in the sense only if the holders' rights are approximately those of other equity shareholders. However in practise, companies are reluctant to concede so much and have restricted the rights in various ways. This, together with opposition from Trade Unions is probably the reason for the failure of such schemes. It had been hoped that such a scheme would provide a solution to the problem of harmonising the relations between capital, management and labour.

To know the theory behind financing is not enough. A survey of enterprises to find out their methods of financing and of banks to note their criteria for lending is the only way to discover the relationship between theory and fact. In addition, it is also possible to detect any underlying note of disappointment or

disatisfaction (if any) with the modes of financing under our present legal structure.

The Banks will tell us what their criteria for lending is. There is no better source to note, first-hand, what are the different forms of securities that they demand, and get, from enterprises. From the enterprises themselves, information will be obtained with regard to their methods of obtaining capital, both initial capital and subsequent capital for expansionary projects, and more importantly, of the various forms and methods of securing their debts and liabilities. Is there a distinctive pattern as between private companies and statutory corporations? If there is, is there any significance in this?

The data and materials gathered from the various enterprises and institutions will be presented after a discussion of each particular type of financing and the various forms of securities required.

As far as shares are concerned, banks do accept shares as a form of security for loans. To take an example, if company X has shares valued at $100,000. It hopes to obtain an overdraft facility to overdraw on its current account. It would be allowed to do so to the extent of 60%. The amount loaned is less because of the insecurity and the fluctuating nature of shares. The Bank will, in the meantime, check constantly on the value of the shares. If the value drops, then the security offered will be less, and the Bank may reduce its overdraft facilities accordingly.

It is also to be noted that banks normally only give short-term loans on securities like shares.

Bonds and Debentures

Another primary source of enterprise financing is provided by bonds and debentures. A debenture is a document given by a company as evidence of a debt to the holder, usually arising out of a loan and most commonly secured by a charge. The word 'debenture' has been used to cover many things but it generally means one of a series of documents described as debentures, all ranking pari passu [39] by which the company promises to pay a fixed sum and interest, and charges its property, both present and future.

There are several kinds of debentures of which the most common are:

(a) Debentures payable to registered holder, and

(b) Debentures payable to bearer.

(a) Debentures payable to registered holder

Debentures such as these are often accompanied by a trust deed charging specific property of the company by a legal mortgage or a legal charge in favour of the trustees of the debenture holders and charging the rest of the estate or assets of the company by a floating charge. The date fixed for repayment of the capital is generally five, ten or twenty years after the issue, or they may be payable on demand or they may be perpetual. If so, then the capital money only becomes payable when any of the things specified in the debentures occurs.

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39 "Pari passu" means that all the debentures of this series are to be paid rateably, so that, if there is not enough to go round, they shall all abate proportionally.

The interest on debentures is a debt and may be paid out of capital.

Earlier, the concept of a floating charge was introduced. This means that the assets of the company are charged with the payment of the debt, but the company may deal with any of the assets in the ordinary course of business, unless the charge becomes a fixed charge. This happens when the money becomes payable under the conditions in the debenture and the debenture holder takes some steps to enforce his security. The charge is then said to "crystallize".

(b) Debentures payable to bearer

The object of this type of debentures is that it may become a negotiable instrument. This has distinct advantages in that it is transferable by delivery. A transferee in due course gets a title independent of any defects in the title of the transferor. No notice of transfers need be given to the company and no stamp duty is payable on the transfer.

It is to be noted that we have now proceeded to a discussion on securities. It would be quite in order at this juncture to go into a brief discussion of the various securities offered by enterprises in order to obtain loans, overdraft facilities and financing in general.

The most common form of security demanded from companies and enterprises by banks, finance companies and other lending institutions

is the issue of a debenture under which the company charges or mortgages its assets, be it the plant, the factory, its stock in trade or even its land. The mortgage or charge may be incorporated into a single document known as a Trust Deed, which is referred to in each debenture certificate (rather than being incorporated in the debenture itself). The Trust Deed will provide for a trustee, in whom will be vested the rights of mortgages in trust for the individual debenture shareholder.

As far as banks are concerned, loans may be secured by the issue of debentures or a fixed charge or floating charge over the company's plant, land, stock-in-trade or any of its current assets. The sum loaned is not equivalent or proportionate to the value of the asset charged. For instance, if the value of the land charged is $100,000, the bank would be willing to give a loan of $80,000, thus providing for a 20% margin.

Some banks also provide what is known as an Advance Against Bills. But it should be noted that this is not the general practice. Certain banks also give an overdraft or a loan on the life policies of individuals, but again it should be noted that this is more of an exception than a rule.

Another form of security is the use of a Memorandum of Deposit or a Blank Transfer. But the use of this form of security has its inherent dangers and could lead to abuse.

The wide use of End Financing or Mortgage Financing is also worth mentioning. For instance, in cases of Housing Development Schemes, no title to the house would be issued in the initial stage of

development. If X then wishes to secure a loan to purchase the house, the bank will require that X signs the following documents, namely, the loan agreement, a charge in escrow and X's agreement with the Housing Developers. This last agreement is to be assigned to the bank. Thus, the minute the title deed to the house is issued, the bank will take possession of it. Sometimes, as an extra precaution, the bank will make an agreement with the developers whereby the latter would transfer the title deed of the house direct to the bank. But even all these precautions does not make the bank's position entirely safe. X could still go to another bank, and if he does, problems would arise as to the question of equitable priorities.

Letters of Guarantee from a director of the company or a person of authority or status to the bank concerned is another form of security often in use. But they are only good for loans and overdrafts up to a sum of $5000. Up to this amount, Branch Managers have a discretion whether or not to grant the loan. However, loans given under letters of Guarantee are for short-terms only and for comparatively small sums too.

It is a common occurence that small contractors are in need of money to tide over their financial difficulties. For example, when small contractors made agreements with the JKR to build pipes, they would be paid progressively under their agreements. Thus the bank uses that progressive payment as security. The contractors would have to sign a deed of assignment. Furthermore they would have to open an account with Bank Bumiputra and assign all payments to it.

Pledges is a method of securing debts common in India. However, the only Bank that accepts pledges in Malaysia is the United Asian Bank. (UAB) Under this system, the bank keeps the client's jewellery or other valuables as security for the loan that they give. For instance, if the security is a necklace, worth say, $1000, the bank will give a loan of $600 and keep the jewellery. Banks like Bank Bumiputra refuses to accept pledges as security because in their opinion, transactions of this sort degenerates the role of a bank into that of a pawnbroker.

However it should be noted that there is a slight difference between ordinary banks and merchant banks. Merchant banks also ask for securities like a charge or debenture over real or movable property. Other activities include Bill Discounting or Bills of Exchange in which trading companies who need money to pay for materials would sell their Bills to the bank. But one difference is that merchant bankers do not give overdrafts. As has been said, " Merchant banks are supposed tc be supplementary to the activities of commercial banks and their purpose is not to compete with them."

Thus it would be quite in order to say that ordinarily registered companies, private and public would have to provide securities for loans. In the normal course of practice, this would take the form of a charge over the company's assets, its shares and even through personal guarantees of its directors.

Under the Contracts Ordinance, a Guarantor is tantamount to the principle debtor. Directors are sometimes required to give personal guarantees for the loans of the company. In the event of default of payment, the directors would be liable both jointly and severally. However it should be noted that directors provide personal guarantees only as a form of cover up. Banks insist that they do not, on the whole, look at whether a particular Director of a company is a V.I.P. or a person of social standing before considering the loan. Instead, they insist that they look at the securities offered.

Talking about guarantees, it would be quite in order to discuss the Credit Guarantee Corporation Berhad. As a result of discussions between the Minister of Finance with the heads of all the commercial banks in the country with the aim to exploring ways and means of increasing loans to small scale enterprises both in the rural and urban areas, the Credit Guarantee Corporation Berhad was incorporated on July 5th 1972. It had an authorized capital of $20 million and a paid-up capital of $2.5 million. [40]

The loans eligible for guarantee under the scheme are to be granted generally for purposes of working capital or for the purchase of capital assets. The ceiling for individual loans ranges from $5000 to $25,000. [41]

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[40] 1972 Malaysia Year Book. Of this sum, 1/5 was subscribed by the Central Bank and the remainder by the commercial banks.

[41] This depends on the purpose of the loan and the size of the enterprise in terms of land or cost of equipment.

As the Corporation covers 60% of any default that would be incurred by the banks on eligible loans and advances, the Commercial Banks are expected to provide credit under the scheme at a reasonable cost. The rate of interest chargeable on such eligible loans has been prescribed by the Corporation at 8½% per annum.[42] It is to be noted that interest is only to be paid upon default. The amount defaulted then becomes a loan from the C.G.C. The introduction of the scheme should encourage the commercial banks to adopt a more dynamic policy so that small entrepreneurs would now be able to play and assume a more active role in the development process.

This scheme has, however, one distinct disadvantage, that is, under the Credit Guarantee Corporation Scheme, one of the conditions for the agreement between the corporations and the banks is that the banks must exhaust all possibilities of recovering their debts. This involves the waste of a lot of time, labour and expense on the part of the banks.

One very important form of security, not to be trifled with is that of government guarantees. For instance, the only form of security that MISC (Malaysian International Shipping Corporation Berhad) gives for its loans is Government Guarantees. This is seen in an incident where MISC placed orders for five Liquified Natural Gas (LNG) tankers worth about $1,700 million. Contracts for the construction of the tankers were awarded to two French companies; when the agreements between MISC and the shipbuilders were signed,

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[42] This includes the guarantee fee of ½% per annum on the outstanding balance.

the Secretary General of the Treasury signed the government guarantee.[43]

Another example can be taken from the case of the Malaysian Airline System (MAS). The basic source of capital which MAS obtains from the Government is not enough. Therefore it was bound to borrow from the commercial banks or other sources at a ratio of 1:3 or 4, that is, for every one dollar given by the government, it had to borrow three or four dollars from outside sources.

MAS borrows from the Export and Import Bank of America for the purchase of aeroplanes. These loans were guaranteed by the government. Thus there was no need for debentures or a charge over its shares.

Finally, to substantiate and clarify the position with regard to securities, we now turn to a number of statutes. We shall look at each statute in turn and examine the provisions that provide some insight into the law as regards securities.

The Companies Act contains certain provisions with regard to the creation of charges. Section 108 of the Companies Act requires registration with the Registrar of Companies within thirty days of the creation of certain charges. Severe penalties result from a failure to comply. Furthermore, section 115 requires the company to keep a copy of every instrument creating a charge at its registered office.

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[43] Berita MISC. Volume 11. No.4. December at page 1

These provisions are extremely important from the point of view of the lenders. When a loan is being contemplated, the bankers would have to know whether there is a prior charge to the property or any of the assets charged. If so, then the other party would have a prior equitable right. But if the bank held the first charge, then it would be wise and prudent to lodge a caveat to secure it.

The Contracts Ordinance and the Extended Credit Act defines certain words which are relevant to our study. The Contracts Ordinance 1950 [44] defines the word "guarantee". A contract of Guarantee is said to be a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the "surety", the person in respect of whose default the guarantee is given is called the principle debtor and the person to whom the guarantee is given is called the creditor. [45]

The concept of guarantees has already been quite extensively dealt with under government guarantees, guarantees of directors, Letters of Guarantee and the Credit Guarantee Corporation. Only one more point remains to be mentioned. In all forms of guarantees except government guarantees and loans secured by the CGC, this form of security is only good for obtaining relatively small amounts and for only a short term. This raises serious problems with

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[44] Act No. 14 of 1950. Revised 1974.

[45] As defined in section 79 of the Contracts Ordinance.

regard to financing. It would be a significant step forward if something were done to give guarantees a better standing as compared with other forms of securities.

The word "bailment" is described as a delivery of goods by one person to another for some purpose, upon a contract that they shall when the purpose is accomplished, be returned or otherwise disposed off according to the direction of the person delivering them. [46] The person delivering the goods is called the "bailor" and the person to whom they are delivered is called the "bailee". However, this concept of bailment is of lesser importance because this is not exactly the best method for securing a loan.

Section 125 of the Contracts Ordinance defines a pledge. It reads: "The bailment of goods as security for payment of a debt or performance of a promise is called a "pledge". The bailor in this case is called the "pawnor" and the bailee is called the "pawnee". The Ordinance provides that the pawnee may retain the goods pledged, not only for payment of the debt or the performance of a promise, but for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged. [47] As has been stated in an earlier part of this paper, only one Bank in Malaysia accepts pledges as security. This is the United Asian Bank. It has been

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[46] Section 125 of the Contracts Ordinance.

[47] Section 126 of the Contracts Ordinance.

pointed out quite strongly by those in the banking profession that pledges are unpopular because acceptance of them would tend to degenerate a bank into something close to a pawnshop.

The Extended Credit Act [48] was an Act to authorize the raising of loans outside the Federation in the form of receiving goods and services and delaying the payment of the price thereon to some future dates and to provide for matters connected therewith. The Act defines "an extended credit arrangement" as an arrangement whereby a party to the arrangement accepts goods and services from another party and is allowed under the terms of the arrangement to delay payment of the price of the goods so accepted and the value of the services so rendered together with interest thereon to some future dates.

Under this Act, the Minister was empowered, from time to time, for the purposes of the Development Fund or other purpose, to enter into extended credit arrangements outside the Federation. Furthermore, in order to give effect to the terms of any such arrangement entered into, he could issue bonds, promissory notes and other instruments on such terms and conditions as may be determined by or with the authority of the Minister. [49] It is to be noted that any agreement entered into under this Act must not be contrary to the provisions of the Constitution and this Act

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[48] Act No. 50 of 1966

[49] Section 3(1)(a) of the Extended Credit Act, 1966.

itself, which contains a provision to the effect that "the price for goods received and the value of services rendered ... shall not in the aggregate exceed $300 million. " [50]

One very obvious and distinct advantage of the Extended Credit Act, 1966 is that section 4(2) provides that the Minister may by order published in the gazette:

"(a) provide that any tax or duty payable under any written law relating to Income Tax or Stamp Duty respectively shall be remitted where such remission is necessary to give full and complete effect to any such arrangement, bond, promissory note, instrument or guarantee."

Subsection (b) also gives exemptions from exchange control as the Minister considers necessary. In brief, this Extended Credit Act is a means for obtaining goods and services now, but the payment for these goods and services only comes later. This Act, carefully used, could prove to be one of the most useful methods of obtaining money for development purposes.

It can thus be seen that this Act presents distinct advantages. It is a means of obtaining financing (within limitations) and consequently, it is an instrument with which to boost the economic and social development of the country. The power to obtain goods or services to the value of $300 million and delaying payment to some future date is an immense one, and not to be underrated.

The Trust Companies Act 1949 [51] which was revised in 1973,

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[50] The Extended Credit Act, 1966. Section 3(1)(a).

[51] Act No. 100 of 1973.

is an Act to provide for the registration and regulation of Trust Companies in Malaysia. The particular provision which is relevant to our study is section 20(1) and (2). Section 20(1) says that for the purposes of obtaining the objects of the company, " a trust company may from time to time borrow money .... provided that the aggregate of the sums borrowed shall not at any time exceed the amount of the company's capital for the time being paid up. " Subsection (2) goes on to say that the money borrowed shall not be secured by debentures on its capital or general undertaking, but may be secured by any of the company's property. Thus, we can see the kinds of security that the Trust Company can give in order to obtain loans. However, it is arguable whether the restriction in forbidding the giving of debentures on its capital or general undertaking serves any function. It takes away a substantial and important method of securing loans much favoured by Banks and in return, gives no appreciable benefit whatsoever.

In passing, two Acts which empower the borrowing of money for development purposes should not be forgotten. The Housing Loans Fund Act 1971 [52] was an Act to authorize a sum of $1000 million to be raised by way of loan for the purposes of the Housing Loans Fund of the Federation and to make provisions dealing with financial procedure governing the Housing Loans Funds of the Federation and the States. The second Act is the Asian Development Bank Act,1966. Under this Act, the Minister was authorized to subscribe on behalf

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[52] Act No. 42 of 1971.

of the Federation to shares of the original authorized capital stock of the Bank in such amount as will not exceed twenty million United States dollars.[53] Section 6 provides that for the purposes of providing any sums, the Minister may create an issue to the Bank in such form as he thinks fit, any such non-interest bearing and non-negotiable notes or other obligations which may prove to be acceptable to the Bank in place of such sums. It will be observed that the requirement that the notes issued be non-interest bearing and non-negotiable is a matter of the nation's self-interests.

In conclusion, we will see that the various statutes studied gives us a number of guidelines as to the types of securities which are acceptable. There is no fixed criteria. But one conclusion that we can draw is that the above-mentioned statutes gives a variety of powers which greatly aid the raising of capital and financing in this country. No doubt some of these provisions also prohibit the using of certain methods for the raising of capital, but overall we can safely say that the prohibitions are overshadowed and outnumbered by the authorizations.

Government Loans

This is a very important source of financing. Under the Second Malaysia Plan, the government is to play a more active role in commerce and industry. This is to be done through loans to the

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53 Section 4(a) of the Asian Development Bank Act, 1966.

public sector but more importantly, through the setting up of statutory corporations which obtains all or at least a majority of their financing in the form of allocations or loans from the Government. These loans are granted without or at least very low interest rates. Apart from direct loans, the Government also helps by guaranteeing the loans of certain statutory corporations.

To see the role played by the government, it is sought to study a few statutory corporations as well as private companies set up with government backing, to examine the manner in which these enterprises obtain their financing.

The National Corporation Berhad or Perbadanan Nasional Berhad (PERNAS) was incorporated as a private company in 1969 to promote increased participation of the indigenous community in commerce and industry, either through subsidiary companies or jointly with other organisations. In addition, the corporation provides the expertise required in the setting up of business ventures and acts as an agent for the distribution of goods to the indigenous community.

The authorized capital of the Corporation is $50 million. At the end of 1970, the called up capital was $11.3 million subscribed by the Federal Government, the Central Bank, the Pilgrims Management and Fund Board, the State Development Corporations of Pahang, Selangor and Perak and Bank Bumiputra Malaysia Berhad. The subscription by the Central Bank amounted to $2 million. The Federal Government provided an additional $5 million in loan capital.

It is very important to note that when PERNAS needs additional capital for its expansionary projects, it borrows from its share-

holders and therefore they offer no securities for the loans. Thus there is no question of debentures or fixed and floating charges. Furthermore, from its fixed deposits, PERNAS obtains overdraft facilities from banks.

We now come to the Majlis Amanah Rakyat (MARA) which is a statutory corporation set up by an Act of Parliament.[54] MARA's initial capital came basically from the Government Treasury. As one of the government agencies that play an important role in the implementation of the New Economic Policy, MARA is intensifying its efforts to further the participation and increase the number of Bumiputras in commerce and industry.

MARA comprises various divisions, for instance, the Servicing Division, the Personnel and Administrative Division (ICD). For example, the ICD obtained $1 million from MARA which was used to set up its revolving fund. The fund is then applied in different manners, for example, the buying of shophouses. The shophouses are then rented out and the rent is then put back into the revolving fund.

MARA itself has also set up many companies which are solely run by MARA. It obtained an initial capital of $100 million and from this allocation, it carries out its activities.

Among the companies established by MARA is the Perbadanan Pemasaran Batik Bumiputra Berhad. This is a joint-venture between MARA and East Coast Batik makers. The Company acts as a wholesaler

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[54] The Majlis Amanah Rakyat Act, 1966.

for batik and other handicraft and supplier of raw materials such as white cloth, wax, dyeing stuff for batik makers, threads for songket weaving and brass for brassware.[55]

Then there is SENAMA Sendirian Berhad, a wholesale company supplying provisions to retailers, and Syarikat Perusahaan Kayu Sedia Sendirian Berhad which is a company engaged in timber processing such as kilning and drying timber for prefabricated houses and furniture. Kulitcraft Sendirian Berhad, another company established by MARA produces leather shoes and boots and at present supplies these goods to the Malaysian Armed Forces. There is a host of other companies established by MARA, and among them are Kimia Sendirian Berhad, USMETA Sendirian Berhad, Lori Malaysia Sendirian Berhad, Limbongan Timor Sdn Berhad, Syarikat Pamagrima Agricultural Machinery and Steel Sdn Berhad, Syarikat Mawar Sdn Bhd and Syarikat Jelantek Sdn Berhad, to name but a few.

When MARA borrows money, it is through agreements between the Government of Malaysia and MARA itself. Since MARA is a statutory corporation, it gets all its capital directly or indirectly from the government. For instance, one of the companies established by MARA is the Syarikat Ubiyu Malaysia Berhad, which produces starch, animal feed from tapioca, tapioca chips and pellets for home markets. Ubiyu needed money to buy certain machinery. It applied to MARA who in turn entered into an agreement with the government to borrow

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[55] The materials relating to MARA were obtained from the 1972 Malaysia Year Book and other undisclosed sources.

money. The Government in turn borrowed from the Danish Government. From this, it is understandable that MARA faces no problems with regard to financing. With the aid of the government in its financing, it derives a lot of advantages which are not available to other public and private companies.

MARA does not borrow from finance companies or other local sources. There is no necessity to do so.

MARA was set up so that the government could establish an institution which possess independence as well as the power and ability to set up various other divisions. For example, Bakimore Sdn Berhad was a project set up under the ICD and its purpose was to run the shophouses owned by it.

For its loans from the government, MARA does not require any security. As has been said, "The loans are based on Trust. "

However, when MARA lends money, it is a different matter altogether. There is a requirement for security. Normally the security required is a charge over a piece of property, for example, a piece of land or personal guarantees from two guarantors. If the loan is not repaid, they would foreclose on the land or they would take action against the two guarantors.

A special feature about MARA's loan programme is that generally loans issued are backed by appropriate technical and advisory services to help entrepreneurs obtain the maximum benefit from the loan facilities. The loans guaranteed are therefore in the nature of "supervised credit". Advisory services provided by MARA include technical, financial, marketing and management advice and they are available not only to receipients of MARA loans but to other

Bumiputra entrepreneurs.

MARA's objective is a good one. The Majlis Amanah Rakyat Act, 1966 is very wide and exhaustive. Its aim is in helping the Bumiputras, especially the rural folk, obtain a leeway in business and commerce. The only question is how far the bumiputras respond to their aims.

Without government backing and loans, MARA would never have come into being. If that were so, a great number of services and functions carried out by MARA to facilitate the public would have been lost.

In discussing enterprises in which the government has played an important part, mention should be made of MISC. The Malaysian Government Cabinet Committee on Shipping chaired by the Hon'ble the Minister of Finance, Tun Tan Siew Sin, on 1st November, 1968, agreed to appoint the Malaysian International Corporation, which was then in the course of formation as the National Shipping Line. The company was then incorporated on 6th November, 1968. [56]

At the time of incorporation, it had an authorized capital of $20 million. However this was recently increased to $100 million.[57] The decision was taken by the Corporation's shareholders at an extraordinary general meeting held in Kuala Lumpur in 1974. The resolution for the increase, which was adopted unanimously, called for the creation of $80 million ordinary shares of one dollar each to rank at par with the existing ordinary shares of the Corporation.

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[56] Pamphlet issued in Commemoration of the Launching of the M.V. "BUNGA RAYA". July 31 1970. In the Message from Mr. Kuok Hock Nien, Chairman of MISC.

[57] Berita MISC. Vol.11 No.4. December 1974 at page 5.

The Government owns the majority of shares in MISC. The other shareholders are businessmen and shipbuilders. Loans were obtained from the Bank of America, the Bank of France, Bank Negara and other Banks, but no loans were taken from finance companies. For instance, MISC acquired M$72 million from the Bank of America for the corporation's future fleet expansion under the Second Malaysia Plan.[58]

Government's support is considerable. As has been said, "Apart from placing their faith in the MISC, the Government has also given financial support in the form of loans, thus helping the company to place orders for ten new ships over a short space of time."[59]

Besides loans, MISC also obtains grants to carry out its objectives. For instance, the Bunga Orkid was the first of two ocean-going cargo ships whose construction were financed by the Japanese Government from its $25 million Goodwill Grant to Malaysia in accordance with the terms of an agreement signed between the Government of Malaysia and the Government of Japan on 21st September 1967.[60] This can be seen as a form of government backing.

Since MISC is the national line, it faces no problems with regard to financing. Money also comes in from export and freight charges.

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[58] Berita MISC. Vol. 11 No. 4. December 1974 at page 2.

[59] Berita MISC. Vol. 1 No. 1 March 1973 on page 1.

[60] Pamphlet issued in Commemoration of the Launching of the M.V. "Bunga Orkid" 27th February 1971. From the Message from the Minister of Finance, Tun Tan Siew Sin.

MISC has also engaged in joint-ventures with other Government institutions and statutory bodies. For instance, Kontena Nasional Sdn Berhad is a joint venture with PERNAS and MARA. This company was registered in August 1971 and started operations in December of the same year hauling containers. Besides, there is Gaya Shipping Sendirian Berhad which was incorporated on 27th September 1971. This is a joint venture between Sabah partners and MISC. [61]

Thus it would not be an exaggeration to say that government backing and loans have been instrumental in the building up of MISC into what it is today.

The final enterprise that we will be considering is the Malaysian Airlines System. Historically it all began on 1st May 1947 when Malayan Airways Limited commenced services. The company went public in February 1958 with BOAC and QUANTAS as its major shareholders while the government of the Federation, Singapore and Borneo Territories held shares. With the formation of Malaysia, the airline changed its name to Malaysian Airways in December 1963 and later in May 1966, became Malaysia-Singapore Airlines. On 1st October, 1972 Malaysia and Singapore went their own ways and each country had its own airline known as Malaysian Airline System (MAS) and Singapore International Airline (SIA). [62]

The initial capital of MAS was made up of money withdrawn from MSA, which was in turn made up of capital supplied by the governments

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[61] Berita MISC Vol. 1 No.4 December 1973.

[62] 1972 Malaysia Year Book page 330-33.

of Malaysia, Singapore, Sabah, Sarawak and Brunei and about 5-10% from commercial firms eg. Mansfield. When the split occurred, Sabah, Sarawak and the Malaysian governments pooled its capital and put it into MAS.

The important thing to note about the financing of MAS, MISC, MARA and PERNAS is their lack of problems with regard to the raising of capital or the obtaining of loans. Capital is readily available from Government sources, and where outside loans are necessary, a government guarantee will always ensure that the loan is got.

CHAPTER IV

CONCLUSION - FINANCING IN PERSPECTIVE

The differences between the methods of financing of companies as distinct from statutory corporations and government backed public corporations has been seen and discussed. As far as registered companies are concerned, their chief source of finance is the sum obtained by virtue of its paid up capital. But for statutory corporations, it is the government that provides it with a share capital which is of a considerable amount, for instance, the Malaysian International Shipping Corporation Berhad (MISC) was initially set up with an authorized share capital of $20 million which has recently been increased to $100 million.

Even more important than the manner in which these enterprises obtain their initial capital is the manner in which they obtain their subsequent capital or funds required for their expansionary purposes or projects.

A registered company would borrow from commercial banks or from other sources like finance companies. But in order to effect a loan, especially a loan of some proportions, it would necessarily have to supply something by way of a security. The most common forms of securing a loan, such as the issue of debentures, the giving of fixed or floating charges over the company's land, property or other assets, a lien over assets or even personal guarantees on

the part of the Directors who would then be jointly and severally liable for the amount borrowed.

The point to note is that as far as a relatively large loan is contemplated, it is essential that the security is also a valuable one. We can, at this juncture, envisage the problems that a registered company would face if

(a) it has a relatively small paid up share capital

(b) it desperately needs a large sum of money with which to tide over its financial state,

(c) the value of all possible assets that could be given as a form of security is insufficient to obtain the loan.

As far as this company is concerned, under our present financing structure where commercial banks and finance companies provide loans only when the security is sufficient to cover the loan, then its chances of securing the large loan is practically nil.

This would represent a step backwards as far as the commercial and industrial development of the country is concerned. The inability to obtain necessary sums by companies would in effect mean that financing under our present legal structure represents an obstacle to further development. If companies are unable to obtain capital with relative ease, how then can they progress?

But as far as statutory corporations are concerned, the incorporating statute would make provisions for its financing. In other words, not only is its initial capital provided by the government, but the government also provides allocations in the form of annual grants. Many examples of this may be quoted, for

instance, Perbadanan Nasional Berhad (PERNAS) was incorporated as a public company in 1969. Under the Second Malaysia Plan 1971-1975, $100 million was earmarked for it. Other statutory corporations were likewise provided for, for instance, $73 million was allocated for the Majlis Amanah Rakyat (MARA), $100 million for the Urban Development Authority (UDA) , $100 million for the Malaysian Industrial Development Finance Berhad (MIDF), $46 million for the Malaysian International Shipping Corporation Berhad (MISC) and $35 million for the Malaysian Rubber Development Corporation. [63]

If the statutory bodies are still in need of funds, no problems arise. Being registered companies too, they are also able to borrow from private sources. But here, the similarities between statutory corporations and other registered companies ends. Statutory corporations face no difficulty with regard to the giving of securities. Unlike registered companies who have to begin a mad rush in search of sufficient securities, the statutory corporation can employ a remarkable weapon known as the government guarantee. As a form of security, a government guarantee is sufficient to borrow any sum, even in excess of the company's paid-up capital.

The common use of government guarantees as a form of security by statutory corporations and government backed public companies, and its effectiveness in securing loans shows that the commercial banks and other sources of capital funds have faith in the integrity

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63 Second Malaysia Plan. 1971-1975. Table 5-1. Public Development Expenditure 1966-75 . pages 68-69.

and solvency of the Malaysian Treasury. If this were not so, government guarantees would carry no weight in the International Financial System.

This can also be viewed as a vicious circle. Because the Government of Malaysia is a stable and a fast developing one, its guarantees are effective to secure any amount of loans. By guaranteeing loans for statutory corporations, it provides the necessary capital for the future expansion, development and progress of commerce, industry, agriculture and finance - in fact, the progress and development of all the sectors. This in turn leads to the further and continued development of the country which means an even stronger and more stable government.

Furthermore the Government has also been known to borrow money from foreign Governments in order to lend it to statutory corporations. This can be seen in the loan given by the Government of Malaysia to Ubiyu Sendirian Berhad, which is a subsidiary of the Majlis Amanah Rakyat (MARA). What is significant is the fact that in order to lend to Ubiyu, the Government in turn had to borrow from the Danish Government. It is no easy matter for a statutory corporation, even though backed by Government guarantees, to borrow from a foreign Government. It is a comparatively simpler matter for one government to borrow from another. Thus as far as statutory corporations are concerned, the help and intervention of the Government in the raising of capital is one whose importance and effectiveness should never be underrated.

The government also helps to finance statutory corporations by the giving of loans. These loans are also interest free which means a considerable amount of savings, especially in this era of high interest rates.

It is to be noted that every statutory corporation that came under survey as well as government backed private registered companies, disclaimed any problems with regard to financing. Loans have even been said to be "on trust" with no security at all.

Thus, government financing and government guarantees would seem to provide the ideal combination for the financing of enterprises. Could the setting up of more statutory corporations be the future trend towards growth and development? Registered companies, though not greatly hampered by the present legal structure with regard to financing (they only face problems relating to securities and the obstacles caused by government red tape) are also limited in their activities by their Articles of Association and the Memorandum of Association. They are unable to exceed their powers and any act done in excess thereof is ultra vires.

Although it has been argued that the growing trend towards the setting up of more and more statutory corporations signify the death of free enterprise, it should also be pointed out that statutory corporations would appear to be the ideal form for future enterprises. They have very wide powers clauses with the additional power to create subsidiaries which would, in the future, branch off into independent companies altogether. Thus it would be possible for one statutory corporation to give rise to a multitude of subsidiaries.

These would later branch off on their own, each specialising in a specific field. These statutory corporations and their subsidiaries would face little or no problems whatsoever with regard to financing. Government allocations, government grants and government guarantees would answer and solve all questions. It is also possible that in the forseeable future, when the country is well established in terms of its commerce, agriculture, industrial and financial sectors, then the need for statutory corporations would cease. These would then be well established and could then proceed as ordinary registered companies.

APPENDIX 1

The following represents the list of Banks and Enterprises in which we have conducted a detailed study and survey:

BANK BUMIPUTRA

BUMIPUTRA MERCHANT BANKERS

PERBADANAN NASIONAL BERHAD (PERNAS)

PERNAS INSURANCE BROKERS

INTAN WOODCRAFT SENDIRIAN BERHAD

MAJLIS AMANAH RAKYAT (MARA)

MALAYSIAN INTERNATIONAL SHIPPING CORPORATION BERHAD (MISC)

MALAYSIAN AIRLINE SYSTEM (MAS)

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APPENDIX II

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