

# CHAPTER 1

## OVERVIEW OF STUDY

### 1.0 Introduction

This study is about a paradox: why is it, despite the extensive corporate governance reforms introduced by the Malaysian government after the 1997 Asian Financial Crisis (AFC), corporate scandals recur in the country? An assessment of this paradox inexorably converges attention on the phenomenon of power and its concentration in a hegemonic state and its executive arm. This issue, a major gap in the literature about corporate governance, constitutes the focal point of this study. Chapter 1 presents the overview of the study, formulates the problem statement and specifies its research objectives. This is followed by a summary of the research methodology underpinning the study and an explanation of its significance, and ends with an outline of the structure of the thesis.

### 1.1 Background of the Study

Corporate and political scandals have been prevalent throughout history, consistently causing immeasurable levels of harm to society as a whole (Markham, 2006). Its most recent manifestation was the 2008 Global Financial Crisis (GFC) and the ensuing globally publicized corporate misadventures, particularly in the European Union and the United States of America. The GFC, having the dubious distinction as the most dire economic calamity since the Great Depression of 1930s, has led to the massive financial losses for innumerable individuals, institutional investors, major corporations and even governments, alongside the social misery inflicted on blameless millions (Blundell-Wignall et al., 2009; Cheffins, 2009; Ely, 2009; Lang and Jagtiani, 2010).

The GFC mirrors the devastating waves and aftershocks of rampant corporate mismanagement and greed on the economy and the welfare of the general public. It also symbolizes the shortcomings and failures of regulatory oversight agencies in under-ratcheting the toxic aftermath of aggregate corporate decisions contributing to organizational deviance (Liederbach, 2010). In predictable knee-jerk reaction, global governments have been compelled to institute unprecedented corporate bailouts pushing an already weakened global economy into a major recession without, however, addressing its core issues.

The GFC traces the core fault lines in contemporary corporate governance frameworks, questioning the efficacy of corporate governance regulations and policy changes<sup>1</sup> emerging since the early 2000s. Regulatory reforms such as the Sarbanes-Oxley Act<sup>2</sup> (2002) and the Organisation for Economic Co-operation and Development's (OECD) Principles of Corporate Governance (2004) responded to the tsunami of global corporate scandals and collapses (namely Enron and WorldCom) to assuage the significant deterioration of public trust in the integrity of financial institutions, business corporations and regulatory agencies.

The GFC is the second major economic crisis that East Asia has endured within a decade. During the Asian Financial Crisis (AFC) in 1997, East Asian economies plunged into an unprecedented financial and economic meltdown severely eroding foreign investor confidence (Rahman and Haniffa, 2005). For example, economic

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<sup>1</sup> Jensen and Meckling (1976) argued that rules and procedures are required to shield the providers of capital. Accordingly, they argue that business practices must observe the laws and regulations and conform to the expectations of communities in which they operate (Jensen and Meckling, 1976)

<sup>2</sup> The Sarbanes-Oxley Act was introduced in 2002 to replace the Banking Act of 1933 (commonly referred to as Glass-Steagall Act).

recession in the Indonesia, South Korea, Thailand, Malaysia and the Philippines, collectively resulted in a massive US\$600 billion wipe-out in stock market capitalization, approximately 60 per cent of their pooled pre-crisis Gross Domestic Product (GDP) (Schwab, 2003), together with debilitating currency devaluation (see King, 2002).

While no consensus exists about the root causes of the AFC<sup>3</sup>, structural economic weaknesses and less than prudent corporate oversight were key issues (Alba et al., 1998). In its aftermath, corporate governance in East Asia implied the absence of accountability, widespread corrupt and unethical business practices and weak and ineffectual governance mechanisms (Backman, 1999; 1999; Nam and Nam, 2004; Mitton, 2002). Of greater importance, a disturbing nexus involving key regulatory and political institutions underpinning the functioning of East Asian economies was discernible. Inherent in this political economy model was the prevalence of concentrated family and state ownership of corporate equity and extensive influence and intervention in business transactions distorting enterprise and economic growth (Rajan and Zingales, 1998). Market competition in these East Asian economies was also constrained by excessive rent-seeking behaviour.

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<sup>3</sup> Two schools of thought exist as to the cause of the crisis. The first argument refers to "first generation model" [developed by Krugman (1979) and Flood and Garber (1989)], which refers to fragile economic fundamentals and inconsistent policies as the main source of crisis. The second argument, categorized as the "second generation model" [introduced by Obstfeld (1996)], provides a more generic explanation of the relationship between country's macroeconomic model with rational expectations of investors. It is believed that the expectations that occur in the market directly affected decision-making of economic policy which contributed to the crisis (see also Roubini and Mihm, 2010:29).

Since foreign direct investments (FDIs) positively relate to perceived good corporate governance, the East Asian economies were compelled to initiate governance reforms to foster enterprise accountability and transparency (see Jomo, 2004). These led to among others; the Indonesian Good Corporate Governance Guidance, 2006; Malaysian Code of Corporate Governance, 2000; Philippines Code of Corporate Governance, 2009; the Singapore Code of Corporate Governance, 2005; and South Korea's Code of Best Practices for Corporate Governance, 2003. With national variations, their common central issues concerned qualitative enhancements to corporate board governance, corporate shareholder accountability and the general governance environment to protect investors (Bhagat and Bolton, 2009; Aguilera and Jackson, 2003).

Despite such regulatory reforms, a disturbing pattern of corporate irregularities and malfeasance continued to surface; more alarmingly, they implicated businesses intimately linked with the state and the ruling political elite. Against such a backdrop, the research concern here is to develop an exhaustive and reflexive understanding of why corporate governance reforms have proven relatively ineffective in managing deviant enterprise behaviour and safeguarding the public interest. As relevant is the examination of the nature and structure of the institutional networks that have proven impervious to regulatory reforms and their embeddedness in the political and corporate context and fabric. This contentious and complex institutional space comprises the central concern of this thesis on the corporate governance environment in Malaysia post-GFC, especially linked to the persistence of corporate deviant behaviour despite the nation's seeming transition to a more transparent and regulated state governance system.

## 1.2 Research Background: Malaysia

Despite Malaysia's remarkable economic transformation since the 1970s (Felker, 2003; Hobday, 2000), Malaysia's substantive corporate governance is perceived as flawed and weak given the systemic recurrence of such business scandals as the Bumiputera Finance Malaysia Berhad (BMF) fiasco of the early 1980s involving a RM2.5 billion loss of equity funds, Perwira Habib Bank Berhad's RM670 million losses from 1985-1986, Perwaja Steel Berhad's RM2.56 billion write-off in the 1990s, and Pos Malaysia Berhad's RM227 million venture wipe-out in Transmile Berhad in the mid-2000s. Government financial bailouts using public funds<sup>4</sup> became the favoured political strategy paralleling limited, unsatisfactory and half-hearted enquiries into their mismanagement; most corporations were government-owned or connected to well-connected businessmen. Such politically-driven and non-transparent solutions presume a *prima facie* case that corrupt business practices in both the public and private sectors are institutionalized in Malaysia's body politic. Malaysia may well have lost up to US\$100 billion since the early 1980s to corruption (Wain, 2009).

To the AFC is attributed the economic manifestations of the opaque corporate governance behaviour in both the private and public sectors (Khas, 2002): the rapid reversal in capital flows and capital flight when nervous domestic and foreign investors lose confidence in capital and portfolio markets is evidenced in the massive declines in FDI and Foreign Portfolio Investments (FPI) (both pivotal to the nation's industrial and capital market growth) of between US\$3.7 billion and US\$5.1 billion, respectively in 1997 (Haley, 2000). A swift and stinging downgrading of corporate credit ratings and

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<sup>4</sup> In December 2006, a Barisan Nasional Deputy Minister announced that RM11 billion of public funds were spent on seven failing privatised companies, which included RM8.2 billion for two light rail companies, which the government took control off. (*The Sun Daily*, 14 December 2006)

significant share price declines led to hasty debt-restructuring measures and more costly project financing.

During this crisis, domestic and international stakeholders were aghast at the prevalence of politically-linked enterprises and their poor governance and financial performance (van der Eng, 2004) defining the cosy, intimate and corrupt linkages connecting the political elite and business class in corporate Malaysia. Given Malaysia's capital market size, the proportion of politically-connected firms was alarming (Faccio, 2002); from 1997 to 2002, there were 81 politically-linked corporations, second only to the 118 in the United Kingdom.

Furthermore, the state's predominant role in its equity and capital markets is reflected in its extensive corporate ownership and control via government-linked companies and institutional investment funds. Additionally, significant corporate ownership by families and individuals closely associated with the ruling political elite have led to the creation of a "crony capitalism" framework where personal connection and political patronage enable preferential access to lucrative state-generated opportunities, credit and other resources: this, rather than entrepreneurial abilities or merit, determine the rise of large enterprises (Chang, 2000; Shleifer and Vishny, 1994). Consequently, corporate greed resulted in over-investment and over-leveraging creating unsustainable bad debt levels and non-performing loans alongside corporate mismanagement and corruption. The moral hazard of "too large to fail" implied a state guarantee against bankruptcies for well-connected corporations through publicly-funded bailouts and rescue packages (Chang, 2000; Johnson and Mitton, 2003; Faccio, 2006; Gomez, 2004).

Post-AFC, the Malaysian government initiated several key corporate governance reforms including a Capital Market Master Plan, demutualization of Bursa Malaysia, initiation of the Malaysian Code of Corporate Governance, changes in the composition and role of Boards of Directors, the Malaysian Institute of Corporate Governance and the Minority Shareholders Watchdog Group. Related measures covered disclosure rules, strengthening corporate whistle-blower protection in 2004 and restructuring of the government-linked corporations (GLCs) in 2005 (World Bank, 2005). Such reforms were directed at restoring investor confidence in corporations, the Malaysian capital market and its regulatory environment. Also, they reputedly reinforced property rights, reduced transaction and capital costs while significantly decreased market vulnerability to future financial crises (World Bank, 2005).

### **1.3 Problem Statement**

Despite the raft of regulatory reforms to consolidate corporate governance post-AFC, the recurrence of business scandals and mismanagement questions their inherent efficacy, or worse, the lackadaisical attempts to enforce them, suggesting an entrenched culture of corruption and symbiotic political-business networks in the country.

Private investments, both foreign and domestic, in Malaysia have not fully recovered from the AFC's impact (Menon, 2012). From being the second largest FDI ASEAN nation after Singapore pre-1997, Malaysia was overtaken by Thailand in 2000, Indonesia and Vietnam in 2008 and the Philippines in 2009 (Menon, 2012). Malaysian FDI inflows declined to an average of RM4.3 billion from 1998-2008, compared to an average RM5.2 billion from 1990-1997. Moreover, only 2.6 per cent of the overall FDI inflows to Asia in 2007 were attributed to Malaysia's FDI, compared to 8 and 10 per cent in the mid-1990s and 1980s (UNCTAD, 2007), paralleling the precipitous decline

in foreign investor confidence. Additionally, private investments have declined, from 31.2 per cent to 10.9 per cent between 1995-2008, associated with a surge in Malaysian direct investments abroad, signalling a loss of confidence in corporate reforms. Only public investments have been relatively stable, from 12.4 per cent to 8.7 per cent during in that timeline (Khoon and Lim, 2010).

Post GFC, a similar pattern has emerged: the Malaysian stock market declined 40 per cent between July 2008-February 2009, obliterating virtually all the market value appreciation in the GLCs since 2004 (Khoon and Lim, 2010). The impact of the GFC, akin to the AFC, reflects the outcome of diffuse and opaque corporate governance practices, weak regulatory oversight and a complicit political-business nexus operating in a “business as usual” outlook (Hicken, 2008; Pepinsky, 2008).

In inaugurating his ascendance in April 1 2009, Prime Minister Najib Razak vowed to usher Malaysia into an era of “transparency, democracy and the rule of law”. However, as with his two predecessors, Najib became Finance Minister, allowing him to control a powerful instrument and bureaucracy for dispensing patronage, resources and rent-seeking opportunities. In March 2010, he unveiled the New Economic Model (NEM) to replace the National Development Policy (NDP, 1990-2010) which made the private sector as the primary growth engine while targeting to reduce the widening national wealth and income gap. The NEM embraced multiple initiatives including modernizing labour laws, public sector reforms and deregulation and liberalization to make the country more globally competitive. Refreshingly, the NEM acknowledged that the country’s political economy model was still plagued by rent-seeking, patronage and crony capitalism (see the *Government Transformation Plan (GTP)* and the *New Economic Model Part 1*) while the 40-year old affirmative action-based New Economic



Policy (NEP) was tasked to apply more nuanced and “market-friendly” affirmative action policies (*The Star*, 31 March 2010<sup>5</sup>). To counter political patronage and crony capitalism, state involvement in business would be minimized by the extensive privatization of GLCs.

However, in spite of the Government Transformation Plan (GTP) and Economic Transformation Plan (ETP), corporate scandals and misbehaviour recur as the nation continues to record poor rankings in the Transparency International (TI)’s Corruption Perception Index (CPI), 2012 Bribe Payers Survey<sup>6</sup> and 2013 Global Financial Integrity<sup>7</sup> (GFI) 2013 report.

In a nutshell, then, the research problem which concerns this thesis can be summarised as follows:

1. Recurrent corporate scandals in Malaysia indicate firm-level corporate governance failures; they incur significant national costs not least of which are the country’s competitiveness as an FDI destination, as a trading nation and its sovereign credit rating. Despite the cyclical corporate governance reforms, governance weaknesses remain evident especially of high-profile and politically-connected companies associated with inadequate governance frameworks,

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<sup>5</sup> PM: Affirmative action a vital component in new economic reality (*The Star* 31 March 2012) Retrieved from the <http://www.thestar.com.my>

<sup>6</sup>Malaysia also ranked at the bottom of 30 countries surveyed by Transparency International’s Bribe Payers Survey. The survey highlighted that 50 percent of companies surveyed had failed to win a contract or gain new business in Malaysia because a competitor had paid a bribe. The survey also discovered that respondents felt that the abuse of public funds by public servants and politicians is common.

<sup>7</sup> In the 2013, Global Financial Integrity's (GFI) Report on illicit financial outflows worldwide, Malaysia ranked 2<sup>nd</sup> out of 150 countries. According to the report, Malaysia lost RM196.84 billion in funds to tax havens and Western banks in 2010.

lackadaisical selective or self-serving enforcement. The plausible causes must lie deeper in and be more fundamental to the nation's body politic: it is postulated that a significant determinant is a political economy model heavily biased to a hegemonic executive arm overshadowing and intervening in the checks and balances normatively exercised by the legislative and administrative institutions of a democratic state. As the multiple case studies investigated in this thesis argue, the ruling political entity, Barisan Nasional (BN, or National Front), in power since Independence in 1957, exercises excessive influence in the corporate arena; the primary source of hegemonic power can be traced to United Malays National Organization (UMNO) which has been the senior partner in the BN coalition government since Independence in 1957.

2. The development state model has fostered proactive government intervention in the corporate sector, one significant outcome of which is the existence of a politically-connected coterie of firms. The four case companies selected for study in this thesis constitute prime illustrations of crony or relationship capitalism involving the government, governing political parties and well-connected businessmen. In all four cases, patronage and rent-seeking opportunities and behaviour as well as lapses of corporate governance and enforcement have occurred.
3. Corporate governance studies actively employ agency theory, stewardship theory and stakeholder theory. These are appropriate theories to help explain and rationalise the limitations of corporate governance regimes and frameworks in the equity market-based governance model, bank-led governance model and family-based governance system. Their composite focus converges on the facet

of firm-level governance which generates useful and significant insights to strengthen corporate governance and its regulation. This thesis, however, explores the wider dimension of corporate governance espoused by institutional theory and the new institutional economics (NIE) which examine how economic gains are generated and allocated in a specific environment. The promising “actor-centred institutionalism” (Aguilera and Jackson, 2003) perceives firm-level corporate governance through the institutional lens to analyse how actors’ interests are socially constructed and enacted. Aguilera and Jackson (2003) and Aguilera (2005) explain that this corporate governance facet is a product of specific institutional configurations linked to the politics of corporate control (Thompson and Davies, 1997). Among others, Turnbull (1997) sees the political model of a state as an overarching framework of a political, legal or regulatory nature governing the allocation of corporate power, privileges and profits at the micro level (see also, Roe, 1996, 2003, 2006; Gourevitch and Shinn, 2005; Cogliancse, 2007; Beloc and Pagano, 2009; van der Wall and Ruis, 2003; Ludvigsen, 2010).

#### **1.4 Research Objectives**

Against this cycle of corporate governance scandals and fundamental regulatory reforms over the last 15 years in Malaysia, this study builds on Gomez’s (1990, 1991, 1994, 2002) investigation of the politics-business nexus by identifying and analysing the systemic forces inherent in this phenomenon (Johnson and Mitton, 2003; Faccio et al., 2006). Exploring the working of political forces enables a more perceptive insight into the matrix of factors corroding the legitimacy and standing of the country’s financial, political, economic and judicial institutions. This would uncover the political economy model parameters shaping the expression of power by the hegemonic political party,

UMNO, the dominant executive arm, a compliant judiciary and civil service administration and the politically-linked companies. The political processes driving the current implementation and enforcement of corporate governance reforms in Malaysia will enable an insightful understanding of the primary sources and uses of centralised power for personal, pecuniary and political goals. This study aims to uncover, through case studies, who controls the key connected corporations, whose interests these enterprises ultimately serve, the structure and configuration of relationships linking the key political and business actors, and how the range of governance mechanisms are enforced and applied in practice.

These broad research objectives have been refined into the following research questions:

**Research Question 1:** Given the research on corporate governance and its failures, what has been the nature of corporate governance reforms in the United States of America, United Kingdom, Australia and the emerging economies, including Malaysia?

**Research Question 2:** What are the roles of politically-connected businesses in the context of the state practising crony or relationship capitalism and what is the nature of rent-seeking behaviours that have engendered and supported them?

**Research Question 3a:** Focusing on the evolution of politically-linked corporations in Malaysia, with special reference to a cross-case study of GLCs, what are the essential dimensions of crony capitalism as they impinge on corporate governance issues?

**Research Question 3b:** What has been the nature of the state's responses to these major corporate scandals?

**Research Question 3c:** Have the state's responses been effective in mitigating damage and harm to society and laid stronger institutional foundations to anticipate corporate governance misbehaviour?

**Research Question 3d:** What are the critical institutional weaknesses contributing to the ineffective enforcement of proper corporate governance and the recurrence of corporate scandals?

### **1.5 Research Methodology**

To delve into this complex and murky politics-business nexus, this study adopts a political economy and institutional approach grounded on the “political business” construct which analytically frames the extensive web of linkages involving political elites and large-scale enterprises. In the Malaysian context, the political elite refers to the powerful leaders with the capacity to exert substantial control over the ruling BN coalition<sup>8</sup> and, in particular, the hegemonic, *primus inter pares*, institution, UMNO. Applying Sherman's (1978) scandal and reform framework, this study transcends the micro-level corporate governance analysis to derive a macro-level political economy assessment of corporate governance reforms in Malaysia.

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<sup>8</sup> The main parties in the BN government have ruled Malaysia ever since independence was attained in 1957. Three major component race-based parties, i.e., UMNO, the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC), dominate this coalition government. The parties have acquired an interest in business to fund their respective political activities (see Gomez, 1994).

A historical approach is adopted to understand the evolution of the corporate sector in Malaysia, where the state's executive branch plays a predominant role in shaping the development of the country. Such a political economy and institutional perspective will delineate the dynamics of the intertwining political-business networks alongside the rise and fall of favoured companies. Utilizing scholarly literature, archival newspaper accounts and an analysis of government policies and initiatives following the AFC and GFC, this study will analytically unfold business scandals and the state's justification for its intervention to rectify problems, including through ostensible corporate governance reforms.

Two key government policies have profoundly shaped the Malaysian political economic landscape where the reliance of business on political networks to operate has been institutionalized, specifically among firms that wish to advance their commercial interests. The first is the affirmative action-based NEP, followed by the 1983 privatization policy (Ozay, 1986; Jomo, 1990, Jesudason 1989; Gomez, 1990, 1994, 2004; Gul, 2006). Subsequently, an appraisal is conducted of the efficacy of corporate governance reforms, oversight, implementation and enforcement post-AFC (Jackson, 2005; Savov, 2006).

To gain an exhaustive appreciation of the persistence of business mismanagement despite corporate governance reforms, four case studies were undertaken of selected politically-connected companies tainted by corporate scandals. These case studies were conducted to examine this ingrained social malaise (Yin, 1994, Eisenhardt, 1989) by adapting Sherman's (1978) model of the cycle of scandal and reform in corrupt police organizations. These cases include: Port Klang Free Zone (PKFZ), Sime Darby Berhad, National Feedlot Corporation (NFCorp), and Tajudin Ramli/Malaysia Airlines System

Berhad (MAS), representing two distinct types of politically-connected firms in Malaysia. The first pertaining to PKFZ and Sime Darby, represent companies substantially owned and managed directly by the state, commonly referred to as government-linked companies (GLCs). Sime Darby is among Malaysia's top 100 publicly listed firms but has weak corporate governance<sup>9</sup>. The second group, NFCorp and Tajudin Ramli/MAS, are enterprises principally owned by politically-linked businessmen and for whom the state acts as patron and protector (Johnson, 2001; Johnson and Mitton, 2003).

The research methodology guiding this study into the recurrence of corporate governance scandals in Malaysia can be formulated as follows:

1. This study applies the qualitative research design to enable a contextual study of the phenomenon of recurrent corporate scandals.
2. This contextual study is conducted at several levels:
  - a. The historical context or perspective is framed by the evolution of the political economy model underpinning the development of the nation. The state interventionist model has evolved into a politics-business nexus primarily driven by the New Economic Policy and the privatisation policy.

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<sup>9</sup> Former Prime Minister Mahathir Mohammed commented on the lack of compliance of corporate governance among GLCs: "Requisitions are made not through proper bids but by the assumption of the government's power. The private sector finds itself at a disadvantage. Some are made to surrender shares without due compensation. Other are denied access to projects as the GLCs arbitrarily assumed rights not provided for. Then the GLCs may actually fail to implement the projects they have taken over. This disregard for corporate governance had led to anarchy and loss of confidence on part of private sector, the growth of the economy cannot be stunted because of this." (quoted in *The Star*, 28 December 2009)

This has led to the practice of crony or relationship capitalism as a strategy of corporate and national growth and development.

- b. The linkages to corporate mis-governance are analysed through the four cases of politically-linked companies (including GLCs and well-connected and favoured businessmen and politicians). The case study methodology is guided by Yin's (2009) model in which basic research questions are investigated following research propositions, analytical units, and the logic model largely based on Sherman's (1978) scandal and reform framework.
- c. Cross-case analysis is applied to validate the existence of broad common themes explaining why the cycle of mis-governance and reforms appears ineffectual.

### **1.6 Significance of Research**

The recurrence of business scandals despite corporate governance reforms challenges contemporary conceptions and theories underpinning the phenomenon. Corporate scandal research enables the uncovering and identification of the factors fostering repeated societal abuse and harm caused by corporate delinquency. The outsize reach and power of large corporations in a modern, post-industrial, globalized world raises doubts and cynicism about the efficacy of national and global regulatory mechanisms to monitor and curb their influence. Four significant reasons rationalize this investigation: persistent occurrence of corporate scandals and the extensive harm suffered by society; lack of scholarly literature on this topic from a political economy and institutional perspective; absence of appropriate methodologies to study them; and the need for effective policies to ameliorate them.



### **1.6.1 Persistence of Corporate Scandals**

While scandals continue to litter the business landscape in spite of corporate reforms, they have not inspired sufficient investigation by academics, practitioners and policymakers (Geis, 2007). The relatively few studies conducted on this complex social phenomenon generally lack analytical depth (Lynch et al., 2004); specifically, business enterprises and the actions of their corporate officers have been significantly understudied by scholars (Simpson, 2002).

Scandals involving large corporations appear universal and have surfaced prominently and consistently in the United States and Europe. Enterprises, including Enron and WorldCom, assumed to be financially and commercially prudent and sound, collapsed under the weight of fraudulent financial structures (Skeel Jr., 2005; Giroux, 2008). Tyco, Adelphia, Global Crossings, HealthSouth, Freddie Mac and Fannie Mae have been publicly tainted by proven accounting fraud and looting of corporate funds by CEOs through stock price manipulation (Giroux, 2008). These scandals have undermined and eroded public trust in business and government as well as public and private institutions and systems (Punch, 1996; Fulmer, 2009). This study critically inspects the persistence of corporate scandals in Malaysia and the ambivalent policies and actions by the state to remedy them.

### **1.6.2 Lack of Scholarly Literature**

A literature review reveals that many studies are either highly normative or focused on firm-level corporate governance practices (Van Apeldoorn et al., 2003). The current corporate governance literature is biased towards the application of agency theory to issues moderating management-shareholder interests (Zajac and Westphal, 2004; Bebchuck and Fried, 2004) while some recent studies extend the repercussions to other

stakeholders shaping corporate governance arrangements (see Bebchuck and Roe, 1999; Gordon and Roe, 2004; Khanna et al., 2006; Pagano and Volpin, 2005; Roe, 2003). Agency theory has vocal critics as it neglects the institutional and social frameworks within which the corporation functions (Otten and Wempe, n.d.); Aguilera et al. (2008) contend that it is “under contextualized” and unable to compare and explain diverse corporate governance models in varying institutional settings. Aguilera et al. (2008) further add that good corporate governance prescriptions must be differentiated to account for diverse institutional environments and not be modeled on generic best practices.

One area absorbing increasing academic interest is the association between corporate governance structures and their overarching political context (Roe, 2006; Gourevitch and Shinn, 2005). According to van de Walle and Ruis (2003), corporate governance reforms are shaped and formed by national political and social institutions contingent on the exercise of state power over the corporate sector. Research on the politics of corporate governance regulations has also materialized more recently<sup>10</sup> but Ludvigsen (2010) argues that this is a relatively new phenomenon.

Thus, the corporate governance literature has not adequately acknowledged the role of the state in advocating corporate governance reform, implementation and enforcement (Baker and Quere, n.d.). This constrains how governance interventions shape various jurisdictions embracing a substantial number of mixed enterprises (co-owned by the state and private investors) and especially their inherent conflicts of interest. Such

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<sup>10</sup> Despite research detailing the current evolution of corporate governance regulation within a national context (see Vitols, 2005; Morin, 2000), most researchers utilize a cross-national view in analyzing regulatory developments in corporate governance systems (O’Sullivan, 2003; Lütz and Eberle, 2007).

ownership patterns imply the extent of “crony capitalism”, an area relatively ignored in the literature (Yu and Main, n.d.). Morck et al.’s (2005) proposal for the formulation of political economy framework of corporate governance provisions as “a fascinating uncharted territory for creative theorists” constitutes the research gap in this study of Malaysia’s corporate governance institutional framework.

### **1.6.3 Absence of Appropriate Methodologies**

Corporate misdemeanour analysis tends to be complex as it constitutes multiple indirect relationships, associations and causal pathways obscuring the sense-making process. Invariably, such analysis revolves around a single case of corporate harm or misbehaviour (Vaughan, 1983; Calavita and Pontell, 1990; Aulette and Michalowski, 2006) raising generalizability issues. Comprehensive analyses of this phenomenon are scarce, while those undertaken lack in-depth, qualitative data for policy making (Sutherland, 1949; Clinard and Yeager, 1980). Alternative study methodologies to guide the analysis of individual and organizational influences on the decision-making processes entwined in major corporate crimes are a major shortcoming (Geis, 2007). In this study, the application of cross-case analysis can serve to add to the evolution of appropriate study methodologies.

### **1.6.4 Need for Effective Policies**

Effective policies to challenge the prevalence and recurrence of enterprise fraud, mismanagement and unethical practices are conspicuous by their scarcity. Invariably, the post-scandal anger driving the demands for state intervention and reform are either diffused over time by extensive and strategic lobbying or the initial failure or reluctance to root out the primary underlying problems. Many corporate abuses and misbehaviour can be limited by simple policies to strengthen governance checks and balances and

eliminating or minimizing potential and inherent conflicts-of-interest (Benson et al., 2009) contingent on the existence and independence of the fundamental institutions of state. More insightful and broader investigations into major corporate infractions can shape policy recommendations to assist policymaking. The analytical emphasis in this thesis is to derive insightful perspectives on the failure of governance reform measures and devise regulatory guidelines to anticipate them.

### **1.7 Thesis Structure**

The thesis is organised into eight chapters. **Chapter 1** provides the background to the study and then goes on to elaborate its significance, research objectives and research design.

**Chapter 2** critically reviews the corporate governance literature assessing the evolution of studies on corporate governance development, major governance models and key theories that have guided and influenced its research directions.

**Chapter 3** presents a second dimension of the literature review encompassing the phenomenon of politically-linked companies and the rise of crony capitalism in different country contexts. The chapter then traces the growth of the role and influence of the state in the Malaysian economy through the formulation of pivotal public policies, namely the New Economic Policy (NEP) and privatization.

**Chapter 4** assesses the raft of corporate governance reforms introduced post-AFC. It examines the regulatory and institutional changes that have ensued and their subsequent effectiveness in attempting to raise the quality of corporate governance in Malaysia.

**Chapter 5** provides a comprehensive review of the adoption of the case study methodology to explore and analyse issues associated with the recurrence of corporate scandals in Malaysia and introduces Sherman's cyclical model of corruption as an analytical tool.

**Chapter 6** examines the four selected corporate case study scandals: Port Klang Free Zone (PKFZ), Sime Darby Berhad, National Feedlot Corporation (NFCorp) and Tajudin Ramli/MAS.

**Chapter 7** discusses the key finding of this study and argues that corporate failure stems from the close relationships between politicians and businessmen and the lack of credible institutional capacity to apply and enforce the governance codes of conduct. Politically-linked companies thrive in a milieu lacking strong regulatory checks and balances and in which the overarching model of political economy implicitly supports enterprise strategies that militate against good governance behaviour.

**Chapter 8** concludes the study by re-stating the study objectives followed by a brief summary of its major findings and implications. The chapter ends with recommendations on effective approaches to foster corporate governance in Malaysia and proposes some recommendations for prospective research.

## CHAPTER 2

### LITERATURE REVIEW: CORPORATE GOVERNANCE

#### 2.0 Introduction

A summary of the progression of corporate governance encompassing the major global corporate governance models and theoretical frameworks will be provided in this chapter. It then turns to the studies on corporate governance scandals and concludes by identifying a current literature gap underpinning this thesis.

#### 2.1 Overview of Corporate Governance

The business corporation's impact on its host milieu has transcended that of being mere productive economic agents to being major players in transformative structural, political and social issues surfacing in economies globally (Anderson and Cavanagh, 2002). This broadening societal influence has led it to its caricature as a "corporate psychopath" propelled by self-interest, greed and profits blatantly disregarding its destabilizing influence on individuals, societal welfare and the environment (Boddy, 2011). Against such a backdrop, corporate governance constitutes an issue of perennial significance to the world economy (Wolfensohn, 1999; Gregory and Simms, 1999). Since the South Sea Bubble in the 1700s, the 1929 stock market crash and the Great Depression in the United States, the prevalence of large-scale corporate scandals has become symptomatic of governance failures, leading to much public policy and scholarly debate.

While academics and practitioners have multiple definitions of "corporate governance", no universal consensus defines it (Anandarajah, 2004) as it is significantly shaped by one's worldview (Gillan, 2006). Mallin (2006) notes its prominence only since the

1990s with its underpinning frameworks grounded on such disciplines as finance, economics, accounting, law, management, sociology, politics and organizational behaviour. At its core, however, is the issue of corporate power and wealth and how this is managed and moderated by the state.

In its narrowest formulation, corporate governance is frequently directed to the functionality of Boards of Directors (BOD) (Blair 1995); Donaldson (1990:376) portrays it as a “structure whereby managers at the organisation apex are controlled through the board of directors, its associated structures, executive initiative, and other schemes of monitoring and bonding.” Tricker (1994:149) extended this to include “owners and others interested in the affairs of the company, including creditors, debt financiers, analysts, auditors and corporate regulators”.

Corporate governance is also perceived as a set of internal provisions for the enterprise specifying the shareholder-management relationship. For Shleifer and Vishny (1997:737), “corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”, while to Monks and Minow (1995:1), “corporate governance is the relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) the shareholders, (2) the management, and (3) the board of directors”.

Corporate governance, however, transcends narrow corporate interests because of its critical impact on economic and social well-being captured in “the structure, process, cultures and systems operation of the organisations” (Keasey and Wright 1993:289). Cadbury (1992:15) perceives it as “holding a balance between economic and social

goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly possible the interest of the individual corporations and society”.

The OECD’s (1999:1) formulation has gained wide currency:

*Corporate governance is the system by which business corporations are directed and controlled. Corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decision on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.*

Two perspectives are embedded in the World Bank’s (1999) concept: the corporate standpoint stresses the links among the owners, management boards and other stakeholders (employees, customers, suppliers, investors and communities). The major role assigned to the board of directors lies in its ability to attain long term sustainable value by balancing these interests. From a public policy perspective, it infers such existential issues as survival, growth and development alongside its accountability through its regulatory control and management framework.

While Blair (1995) conceptualized corporate governance broadly in the ownership and control component as proposed by Cadbury (1992) and Monks and Minow (1995)<sup>11</sup>, its

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<sup>11</sup> Cadbury (1992) and Monks and Minow (1995) proposed that the concept of ownership and control aims to establish an internal management system in a company to deter misappropriation



enforcement was contingent on the state's role and influence. The latter issue is the principal concern of this study in order to appreciate the chronic recurrence of corporate misdemeanours in Malaysia.

## **2.2 Effective Corporate Governance**

No matter what view is adopted, effective enterprise governance ensures that boards and managers are accountable for pursuing it because of its potential societal repercussions.

Effective corporate governance:

- Promotes efficient resource use in corporations and the larger economy. Debt and equity capital should flow to those corporations effectively and efficiently capable of investing it in the production of goods and services most in demand and most profitably. Thus, effective governance can conserve and productively employ scarce resources for better social welfare and ensure that the most competent managers are employed.
- Enables corporations (and nations) to draw lower-cost investment capital by enhancing domestic and international investor confidence; this also ensures that asset utilization is optimal. Although managers must exhibit innovative behavior to compete, regulatory regimes must be in place to protect the interest of capital providers by independent monitoring of management, transparent behavior, ownership and control, and participation in specific fundamental decisions by shareholders.

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of resources. The boards of directors and shareholders are empowered to map the company's direction. By managing the collective interest of all stakeholders, this ultimately aims to encourage investment opportunities.

- Ensures that corporations observe the laws, protocols and conventions of society, ultimately avoiding actions that are technically lawful but raise political, social or public relations concerns.
- Is concerned with the prevention and reduction of business-related corruption dealings although it alone cannot prevent corruption.

### **2.3 Corporate Governance Models**

Corporate governance systems have developed in an *ad hoc* modus (Sison, 2000) influenced by conventions, environment, worldview and culture, as well as the political-legal frameworks in which they operate. Corporate governance systems are shaped by “culture, democratic representation and accountability, the distribution of power, and the protection of property rights and equality” (Sison, 2000: 181). Zingales (2000) further argues that the state of press autonomy and intensity of business competition are also vital factors.

Therefore, corporate governance models are not explicitly intended to realise maximum adeptness or economic profit for shareholder but are driven by a complexity of forces. Based on the portfolio of existing corporate governance systems, there are three general models. The first is the shareholder or equity market-based governance (EMS), where investors exert power through the valuing and purchasing of the corporation’s securities. The second is the Bank-led governance model (BLS), where creditor banks constitute a dominant role in observing firm performance. Finally, there is the Family-Based Governance (FBS) model, in which the founding family retains control despite a dependence on external funds to facilitate growth.

### **2.3.1 Equity market-based governance model (EMS)**

EMS asserts that management preserves the authority to make decisions, frequently in its own interest, sometimes causing over-investment. As management expands, in order for firms to enhance their market power and influence, investments will be made even if profitability distresses shareholder interests (Jensen, 1986).

The insider system in Europe vests control in a selected number of financiers with a plurality of interests (Mayer, 2000). On the other hand, shareholdings (and control) are less concentrated and more widely dispersed in the United States: ultimately, in this “outsider system” of corporate control, a large number of small investors influence the corporate approach and assignment of board of directors.

These different structures governing ownership and control in Continental Europe against the United States and United Kingdom offer dissimilar resolutions to the principal-agency issue. While in the United States and United Kingdom, the central agency problems stems from conflicts-of-interest between the corporation’s administrators and distributed shareholders. In Continental Europe, the issue is between the controlling shareholders and weak minority shareholders. The issue ultimately leads to the conclusion that there is control without dispersion of ownership in Continental Europe (Mayer, 1997, conversely, in the United States and United Kingdom there is ownership without control (Becht and Roell, 1999).

Maug (1998) examined whether a liquid market, such as in Anglo-American countries, improves corporate governance performance. Maug (1998) discovered that in liquid markets, shareholders can unload their investments if adverse company information is obtained. In Continental European countries, where smaller numbers of firms are listed,

shareholders must involuntarily maintain their investments and exercise their voting power to impact company performance. Thus, Maug (1998) concluded that market liquidity fosters effective corporate governance. If voting power is dispersed as in the Anglo-American countries, free-riding will arise as the single shareholder will have to endure the cost of control while only proportionally benefiting from it. As the costs of control exceed the benefits, shareholders are inclined not to react, making management a dominant power by default (Renneboog, 1996).

### **2.3.2 Bank-led governance model (BLS)**

In the United States and United Kingdom, there are many publicly-traded firms with relatively widely-held shareholdings contrasted to corporate ownership in Germany and Japan with a traditionally more concentrated ownership; additionally, German and Japanese banks play more important governance roles.

In a BLS, banks play the prominent role in monitoring firm governance. The bank-centred economies of Germany and Japan exhibit different equity ownership structures. According to Prowse (1992), financial institutions are the most important block-holders in Japan, while in Germany, other corporations and families are dominant (Franks and Mayer, 2001). German banks hold more voting power than their equity ownership as they are proxies for numerous singular shareholders. Therefore, financial institutions have substantial control over firms in both countries. The ownership concentration-firm value link in German firms is strongly correlated with bank block ownership (Gorton and Schmid, 2000). Morck et al. (2000) discovered that the bank ownership-firm performance link in Japan differs over the ownership range and is sturdier with concentrated ownership.

### **2.3.3 Family-based governance system (FBS)**

FBS proposed by Khan (2003:1) “includes the financing, monitoring and performance of family businesses” stressing its asymmetric information and monitoring aspects. Financing FBS in East Asia comes from three sources: in the initial growth stages, family-based corporations are largely financed internally; second, with growth, banks play a more prominent role; finally, outside finance may assume the most significant corporate equity source. Nevertheless, Khan (2003) argues that the key dissimilarity between FBS governance system and the BLS and EMS is that neither the banks nor the equity markets have control over the family business groups.

According to Suchiro (1993, 1997) a key justification for FBS is its flexibility in the executive decision-making practice and efficiency in capital growth in late-comer industrialisation. As catch-up growth in Northeast Asia is largely completed, international competitiveness is progressively more dependent on managerial, product and technical innovations. The firms’ managerial expertise and the industrial organisation can be equally important as the corporate governance form in determining corporate performance (Khan, 1999, 2003).

Khan (2003) asserts that the corporate “historic mission” of capital accumulation demands governance structures conditioned by diverse histories. The predominant FBS structure in the preliminary stage of capital accretion in East Asia and also virtually all Asian countries for funding economic development stages makes it virtually a definitive feature of Asian corporate structure and governance.

FBS corporate governance concerns arise due to the asymmetric information between management and external financiers apart from inadequate regulatory structures, transparency and accountability (Khan, 2003). It can be a viable governance model given appropriate observation of financial systems, managerial expertise and market competition. To improve this model, competent professionals are needed to provide the relevant information to funding financial institutions while formal and informal means to influence their decisions must be explored during periods of poor performance (Khan, 2003).

## **2.4 Corporate Governance Theories**

### **2.4.1 Agency Theory**

According to Eisenhardt (1985), agency theory explains how to define relationships in which the principal determines the work which the agent undertakes. With incomplete information and uncertainty confronting all businesses, two agency issues come across: adverse selection and moral hazard. The former arises when the principal cannot determine whether the agent is the most competent for a specific position, while the latter surfaces when the principal is uncertain that the agent has exerted maximum determination (Eisenhardt, 1989).

Though the narrowest formulation, corporate governance centres on the agency problems that ascend when management and ownership are separate entities (Simanjuntak, 2001); in the modern corporation with widespread share ownership, managerial actions diverge from those required to maximize shareholder returns (Berle and Means, 1932). The application of agency theory to directors and boards began only in the 1980s (Jensen and Meckling, 1976) grounded on the postulation that people are more self-centred than self-sacrificing, maximize their own utility and cannot be relied

to be concerned with the best interest of others (Coase, 1937). As there is a contractual relationship between directors and stakeholders, the former as agents, may make decisions selfishly; to monitor such behaviour, checks and balances incurring transaction costs are unavoidable to reduce non-compliance.

Agency theory is concerned with a firm's ownership structure, achieving the owner's objectives and how the mechanisms of aligning the owner-manager interests evolve. How effective these mechanisms are in preventing actions against the principal's welfare, such as deception on the agent's part, are reflected in the board structure, strategy-setting guidelines and strategic policymaking processes, governance and risk mechanisms are integral to business. Also, it covers selection and remuneration issues which control the agent's behaviour and aligns it with the principal's interests, thus minimizing adverse selection and moral hazard risks.

#### **2.4.2 Stewardship Theory**

Due to its limited explanation of the sociological and psychological devices rooted in the principal-agent relationship, scholars (see Hoskisson et al., 2000; Blair, 1995; Perrow, 1986) have criticized the agency theory in corporate governance studies. Stewardship theory (Donaldson, 1990; Barney, 1990) assumes that managers, acting on behalf of shareholders, aim to be upright stewards of organizational resources and cannot be presumed to have conflicting interest or make clandestine profits at the cost of shareholders. Through the appointment of directors by general membership, to whom managers are accountable to, and the services of an independent auditor attesting that the legitimacy of the firm's accounts and financial statements, control of the behaviour of managers is exercised. This philosophy explains the theoretical underpinning for most corporate regulations (Adams, 2002).

Stewardship theory emphasizes that principal and steward develop a common trust and cooperation, which Tian and Lau (2001) argue is positively allied with the corporation's performance. This ultimately has numerous significant consequences for governance systems, particularly aimed to address information asymmetry problems.

Several aspects differentiate agency from stewardship theory. The first is the assumption sustaining the agency theory, which is that managers will behave opportunistically and self-servingly. On the other hand, stewardship theory considers these managers are honourable and supportive. Second, while agency theory stresses monitoring and control, stewardship theory promotes that principal and steward must build the relationship based on trust. Finally, agency theory focuses on the independence of the stakeholders, which may precipitate "goal conflicts", stewardship theory is motivated by a common understanding to achieve "goal alignment".

Van Thang (2005) argues that stewardship theory is a superior fit than agency theory, particularly for transitional economies (such as Vietnam), whose economic, institutional and social environment requires a review of agency theory's assumptions (Phan 2001). Its applicability to Malaysia is moot as its rampant corruption is emblematic of opportunistic and self-seeking managerial behaviour.

### **2.4.3 Stakeholder theory**

Stakeholder theory, first presented by Freeman (1984), posits corporate accountability to shareholders, employees, suppliers, customers, creditors, nearby communities and the society in general. Solomon and Solomon (2004) argue that an elementary concern is that large corporations exert a pervasive impact on society and should be accountable to other entities than their owners.



Stakeholder theory originates in the communal entity notion of a corporation. Its large scale and scope results in managerial decisions that incur significant external costs on such stakeholders as employees, customers, suppliers, nearby communities and society generally. In the stakeholder-society perspective, corporate governance must induce management to internalize stakeholder welfare through “the complex set of conditions that shape the outcome of the ex-post bargaining over the quasi-rents that are generated in the course of a relationship” (Tirole, 2001:4). Provided modern corporations exert such an extensive influence, Letza et al. (2004) argue that they should be acutely aware of such social responsibilities as social fairness and employee safety.

Letza et al. (2004) argue that while agency theory concentrates on the rights of shareholder and the control of ownership divide, stakeholder theory transcends optimizing shareholders’ wealth to deliver broader yields to multiple stakeholders while emphasizing corporate efficiency in a societal perspective

#### **2.4.4 National Corporate Governance**

It is acknowledged that the extensive corpus of research on corporate governance at the level of the firm framed against the agency and transaction cost, stewardship and stakeholder models applied to the Anglo-Saxon and Rhineland business environments is cogent, significant and path-breaking. This thesis, however, leans toward the analytical perspectives of corporate governance based on political economy and institutionalist thinking primarily because in the emerging economies like Malaysia, the sources of national political power exercise considerable influence on corporate governance at the level of the firm by direct or indirect involvement in business ventures apparently unmitigated by the existing legal and regulatory frameworks. The following sections

trace the outlines of political economy and institutionalist perspectives as they bear upon corporate governance and this study.

#### **2.4.5 Political economy**

The intellectual roots of political economy ([www.sagepub.com](http://www.sagepub.com)) lie in the terms “economics” derived from the Greek “oikos” (house) and “nomos” (law) signifying a system of production, distribution and exchange of goods and services in a state (“polos” being Greek for political or state). In its original formulation, thus, political economy implies “the theory and practice of economic affairs ... applied to broad problems of real cost, surplus, and distribution...viewed as matters of social as well as individual concerns.... With the introduction of utility concepts in the late nineteenth century, the emphasis shifted to changes in market values and questions of equilibrium of the individual firm .... Such problems no longer required a broad social outlook and there was no real need to stress the political” (Horton cited in [www.sagepub.com](http://www.sagepub.com), p.23).

The tide has since turned and political economy came to be construed as the study of “the social relations, particular the power relations, that mutually constitute the production, distribution and consumption of resources.” Amplifying on this theme of power and control over resource use and distribution in a nation, [www.sagepub.com](http://www.sagepub.com) identifies four cornerstone ideas of political economy: social change and history (in capitalist economies as analysed by Adam Smith, David Ricardo and John Stuart Mill and critically disputed by Karl Marx), social totality (social choice theory of the ‘homo economicus’ contrasted with the Marxian, socialist and institutionalist approaches), moral philosophy (appropriate social values and practices transcending selfish behaviour or self-interest) and praxis (the nature and substance of human activities to transform individuals and their environment).

Political economy, in this research exercise, then brackets the unfolding of political power in national governance contexts and defines the gap between the articulated corporate governance philosophy and its actual implementation at the corporate level in a country. Clearly, in developed, transitional or emerging nations, no generic model can be prescribed; individual nations evolve their own corporate governance variants based on their historical and cultural antecedents (i.e., they are path-dependent) and the dynamics of prevailing power scenarios whether politically-rooted or emanating from other sources.

#### **2.4.6 Institutional theory**

According to Scott (in the Encyclopedia of Social Theory, 2004, p.408), institutional theory “examines the processes and mechanisms by which structures, schemas, rules, and routines become established as authoritative guidelines for social behaviour. It asks how such systems came into existence, how they diffuse, and what role they play in supplying stability and meaning to social behaviour. It also considers how such arrangements deteriorate and collapse, and how their remnants shape successor structures. One of the dominant perspectives in the nineteenth century, institutional theory was eclipsed by other approaches during the first half of the twentieth century. In recent decades, however, institutional theory has experienced a remarkable discovery, entering the new century as one of the most vigorous and broad-based theoretical perspectives in the social sciences. Institutional theory is not a single, unified system of assumptions and propositions, but instead a rather amorphous complex of related ideas – a broad theoretical perspective or family of approaches.”

Meyer (2008) depicts the two strands in institutional theory described above as the old institutionalism (where institutions and contexts embed human activity) and the new institutionalism (in which humans are purposive, bounded, fairly rational, and, within limits, free actors). The new institutionalism is founded on the “actor” as individual persons, national states, and organizations created and transformed by such actors. Thus, the old institutionalism views people as being naturally embedded in broad social contexts whereas the new institutionalism studies the tension between and the influence exerted by the actor and the environment.

#### **2.4.7 Institutions**

From the foregoing discussion, a clear understanding of the nature of institutions is a pre-requirement. The analytic contribution of Scott (1995, p.56) is given in his conception of institutions:

“Institutions comprise regulative, normative, and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life.”

These constitute his Three Pillars of Institutions whose dynamics are summarised and explored in Table ... (Table 3.1, Scott, 1995, p. 60) against the elements of compliance, basis of order, mechanisms, logic, indicators, affect and basis of legitimacy.

The regulative pillar constrains and regularizes behaviour by rule-setting, monitoring and sanctioning activities. Regulatory control (or coercion) can be applied informally or formalised in rule-based systems involving obligation, precision and delegation. Of direct import to this thesis, is the elaboration that empowerment (a positive incentive) is integral to this institutional pillar in the form of licenses, concessions, special powers and benefits. Hence, power can be institutionalized in an authority and enforcement

effected, as, for instance, of contracts and agreements (part of agency costs). It is implied that enforcement should be done by a neutral third party thus alluding to a political framework that ensures such an outcome. This raises the possibility of biased third parties acting in their own selfish interests. This institutional approach is much favoured by economists and political scientists.

The normative pillar perceives institutions as serving prescriptive, evaluative and obligatory functions in social life. Goals are defined as are the instrumentalities to achieve them (rules-of-the game). Like the regulative pillar, the normative equivalent imposes constraints while also enabling and empowering social action. This branch of institutionalist thinking is more favoured by sociologists.

The cultural-cognitive pillar of institutionalism supported by anthropologists (including Scott and Meyer) stresses “the shared conceptions that constitute the nature of social reality and create the frames through which meaning is made” (Scott, 1995, p.67). Further (Scott, 1995, p.68), explains that;

“Cultural systems operate at multiple levels, from the shared definitions of local situations, to the common frames and patterns of belief that comprise an organization’s culture, to the organizing logics that structure organization fields, to the shared assumptions and ideologies that define preferred political and economic systems at national and transnational levels. These levels are not sealed but nested, so that broad cultural frameworks penetrate and shape individual beliefs on the one hand, and individual constructs can work to re-configure far-flung belief systems on the other.”

Propositions allied to Scott's three institutional pillars are the concept of institutional legitimacy which varies and may conflict with each pillar, and the deep-seated assumptions underpinning each of them. Suchman (cited in Scott,1995), defines legitimacy as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions." Scott (1995) notes that the "socially constructed system" is none other than society's institutional frameworks; in a regulative model, institutional or organizational legitimacy is legally sanctioned, while it is morally derived and culturally decreed, comprehensible and recognizable in the normative and cultural-cognitive models, respectively.

#### **2.4.8 Institutional theory and Corporate governance**

Institutional theory can inform and be informed by corporate governance because both concern authority and control structures (Fiss, 2008 in Sage Handbook). Supporting the literature gap in this thesis, corporate governance studies have been dominated by the contractarian paradigm embedded in the principal-agency model and concerned with contracts made between owners and managers with elaborations into compensation structures, boards of directors and the market for corporate control. Business-level corporate governance issues are themselves integrated into the larger national systems of corporate governance constituting the institutions underpinning the nature of the state which to Fiss (2008) embodies "the normative theories or logics about the distribution of power and the 'natural' order of interests in the corporation. This makes for a more dynamic and culturally constructed view relative to the contractual model." Fiss (2008) adds that, by their nature, corporate governance models are fragile because they are open to different interpretations, their transmission is affected by social entropy and

techo-economic changes and the links between the fundamental assumptions of generic purposive versus axiomatic models.

An important extension of Fiss's (2008) thinking are the variations in national corporate governance (NCG) which underlies this current study. First, historical, cultural and technological antecedents of a state impact on NCG systems which have been refined into two frameworks: Varieties of Capitalism (VOC) and business systems. Citing Aoki (1994), the VOC approach reflects a part of a larger system of linked and mutually-reinforcing institutions while resisting change. Two variants exist: the liberal market economies (US, UK, Canada and Australia) and the coordinated market economies (Germany, Japan, Netherlands and the Scandinavian countries); in the former, markets regulate financial and industrial systems, while in the latter, regulation is attained by non-market institutions. The business systems approach directs attention to patterns of economic organization differentiated by the extent and type of coordination of economic activities and linkages among owners, managers, experts and other employees. It would appear that both approaches are valuable in generating insights into this thesis although it would seem that the VOC is more predominant in its relevance.

Charreaux (2004) distinguishes between the micro systems of corporate governance and national corporate governance systems resting largely on the tension between the disciplinary (shareholder-stakeholder) and cognitive functions of governance. Charreaux (2004) argues for a different perspective of how value is created in production, combining both disciplinary and cognitive aspects. In the first approach, insights are drawn from law and finance, neoclassical economics and rent-seeking political theories while the second would rest on the thesis of VOC espoused by Aoki (1994).

An innovative attempt using neo-institutional theory was conducted by Judge and Douglas (2008) to identify the country-level predictors of corporate governance legitimacy. Applying Monk's (2007) definition of corporate governance as "one of the means by which a nation channels corporate power for the good of society so that wealth is created efficiently and distributed fairly within a national economy," the authors link corporate governance legitimacy to the means by which corporate power is constrained and directed to efficiently create and equitably allocate economic wealth. It follows thus, that, in a country whose national income and wealth stagnates and is inequitably distributed, NCG is illegitimate. NCG investigations have gained widespread support as they are predicated on institutional contexts as compared the firm-level agency or transaction cost approaches (Deeg and Perez, 2000; Groenewegen, 2004; Aguilera and Jackson, 2003 cited in Judge and Douglas, 2008). Drawing from Scott (1995), the authors chart a conceptual model of institutional theory and institutional forces given in Figure... (Judge and Douglas Fig 1 p.767) and formulate the hypotheses linking law and order (positive), international competitiveness (positive) and corruption (negative) with NCG legitimacy. Based on multi-year panel data from 46 countries, the perception of CG legitimacy was positively correlated with the greater the extent of law and order, the more the culture emphasized global competitiveness, and the less the prevalence of corruption.

#### **2.4.9 Corporate governance in transition and emerging economies**

Recognizing the challenges of corporate governance in transition and emerging economies, the Centre for International Private Enterprise (2002, p.12) proposed a definition widening the need to extend the concerns of corporate governance beyond business-level corporate governance informed by the extant generic insider and outsider systems:



“Corporate governance systems depend upon a set of institutions (laws, regulations, contracts, and norms) that enable self-governing firms to operate as the central element of a competitive market economy. These institutions ensure that the internal corporate government procedures adopted by the firms are enforced and that management is responsible to owners (shareholders) and other stakeholders.”

The establishment and institutionalization of shareholder rights, equitable shareholder treatment, stakeholder role in corporate governance, disclosure and transparency and Board responsibilities must be underpinned by an institutional framework ensuring property rights, contract law, a well-regulated banking sector, bankruptcy and foreclosure as exit mechanisms, sound securities markets, competitive markets, take-over markets, transparent and fair privatization procedures, transparent and fair taxation regimes, an independent, well-functioning judiciary system, anti-corruption strategies, reformation of governments agencies that are excessively bureaucratic and inefficient, strengthening the administrative and enforcement capacity of government agencies, establishing routine participation mechanisms, investigative and informed media, strengthening reputational agents, an active, integrity-based business community, and sound stakeholder relationships.

Among the varied governance challenges in developing, emerging and transitional economies identified by CIPE (2002, p.24) are the following:

- a. Establishing a rule-based (as opposed to a relationship-based) system of governance;
- b. Combating vested interests;

- c. Dismantling pyramid ownership structures that allow insiders to control and, at times, siphon off assets from publicly owned firms based on very little direct equity ownership and thus few consequences;
- d. Severing links such as cross shareholdings between banks and corporations;
- e. Establishing property rights systems that clearly and easily identify true owners even if the state is the owner (when the state is the owner, it is important to indicate which state branch or department enjoys ownership and the accompanying rights and responsibilities);
- f. De-politicizing decision-making and establishing firewalls between the government and management in corporatized companies where the state is a dominant or majority share-holder;
- g. Protecting and enforcing minority shareholders' rights;
- h. Preventing asset stripping after mass privatization;
- i. Finding active owners and skilled managers amid diffuse ownership structures;
- j. Promoting good governance within family-owned and concentrated ownership structures; and
- k. Cultivating technical and professional know-how.

In a survey of corporate governance in Asia, Claessens and Fan (2002) confirmed the “limited protection of minority rights in Asia, allowing controlling shareholders to expropriate minority shareholders, agency problems have been exacerbated by low corporate transparency, associated with rent-seeking and relationship-based transactions, extensive group structures and diversification, and risky financial structures.” The authors stress that the quality of public governance critically influences

corporate governance practice together with the legal environment and the extent of investor protection.

#### **2.4.10 Political Framework Perspective**

The political framework perspective connotes that corporate governance is a task of explicit institutional alignments (Aguilera and Jackson, 2003; Aguilera 2005), necessitating an appreciation of the politics of commercial control (Thompson and Davies, 1997), and the political environment influencing markets and corporate governance mechanisms (Roe, 2003). A more holistic view would recognize the interactions among the institutions and individuals concerned with decision-making (Charkham, 1995; Monks and Minow, 2001).

Turnbull (1997) highlights that the political model as a macro framework for political, legal or regulatory systems, while governing the provision of corporate power and profits at the micro level. Corporate governance arrangements internal to the firm interface extensively and deeply with a nation's political life (Roe, 2003). Political forces (i.e. political party structures, orientations of governments and coalitions, ideologies and interest groups), determine the shareholder distribution and linkages among administrators, owners, staff and other stakeholders of the firm. Whatever the formal corporate law is, the political calculus that influences all actors' decisions; the political arrangement, as a pulsating institutional influence, has been central to the scholarship of institutional influences on corporate governance (Gourevitch and Shinn, 2005; Coglianese, 2007; Belloc and Pagano, 2009; Roe, 1996).

## **2.5 Corporate Scandals**

Corporate scandal studies, mainly examined in the United States because of data availability, investigate phenomena involving financial fraud and misrepresentation in prominent corporate fraud cases. For instance, it is argued that firms can suffer huge market value depreciation if they engage in accounting manipulation (Karpoff et al., 2008a). Scholars also conclude that high-ranking personnel involved in deceptions are widely expected to have their services terminated of their services (Desai et al., 2006; Karpoff et al, 2008b).

Most of the limited studies on non-United States corporate scandals concentrate on financial misrepresentation. For example, Weber et al.'s (2008) examination of stock and audit market implications arising from the accounting fraud of ComROAD AG in Germany revealed KPMG's clients (ComROAD's auditor) sustained significant negative and abnormal returns during the scandal period. Another study by Fan et al. (2013) on the market price reaction to China's accounting frauds identified evidence of information spill over across firms in the same industry. An exception is the research by Fan et al. (2008) which found a decline in Chinese listed firms' financing capability following corruption charges involving high-level government bureaucrats, although their focus was on corruption charges against government officials and not directly against the firm or its managers. According to Hung et al. (2011), corporate scandals in developing economies can impact firm value by severing social and political ties enabling their relationship-based contracting and eroding market confidence in them.

## **2.6 Gaps in Corporate Governance Literature**

A literature review reveals that corporate governance studies are predominantly focused on firm-level corporate governance practices (Van Apeldoorn et al., 2003). Current governance developments concern other actors, besides shareholders, managers and institutions, who can significantly shape such oversight arrangements (Bebchuck and Roe, 1999; Pagano and Volpin, 2005). To van de Walle and Ruis (2003), enterprise reforms are located in their socio-political contexts while their outcomes depend on the state's influence on the corporate sector.

The corporate governance literature has, however, inadequately acknowledged the state's role and influence (Baker and Quere, n.d). In excluding this central political entity, conventional governance models have insufficiently explored the political economy of corporate oversight. Moreover, the large and increasing range of jurisdictions of state-linked firms, including mixed enterprises, defined as corporations in which there is government-private ownership, has not been reviewed from the perspective of corporate regulatory oversight. Of greater importance are their consequences stemming from the inherent conflict-of-interest situations in the state's dual role as shareholder and corporate governance regulator. It is hoped that this study on the recurrence of corporate scandals in Malaysia will contribute to a greater understanding of this under-studied gap.

## CHAPTER 3

### POLITICALLY-LINKED COMPANIES

#### 3.0 Introduction

This chapter pertains to the literature on politically-linked companies beginning with the discussion on the substance of political connection followed by an overview of crony or relationship capitalism. It then traces the development of politically-linked companies in Malaysia as one major outcome of the implementation of two critical policies, the New Economic Policy (NEP) and privatization, against the backdrop of Malaysia's economic growth and the recession ensuing from the 1997 Asian Financial Crisis (AFC). A discussion of the performance of politically-linked companies consequent on this crisis in the country will round off this chapter.

#### 3.1 Defining of political connections

According to Faccio (2006:370) a company is defined as politically-connected if “at least one of its large shareholders (anyone controlling at least 10 percent of voting shares) or one of its top officers (CEO, president, vice-president, chairman, or secretary) is a member of parliament, a minister, or is closely related to a top politician or party.” Close relations refers to situations where a politician's immediate relatives serve in such a capacity. Close relationships may also include: companies whose top officials or large shareholders have been labelled in the press as a close associate of a Head of State, government minister or member of parliament; networks with officials who had served as Heads of State or prime ministers previously; companies whose former top officials or large shareholders are involved in politics; and links with foreign politicians (Faccio, 2006; Gomez and Jomo, 1997; Johnson and Mitton, 2003). A political

connection also refers to a company engaged in “indirect political connections” by, for example, lobbying, sponsorship of a political party, having family members who are politicians, or firms owned by a politically-connected company. Other manifestations of political connections such as monetary inducement and bribery, political campaign assistances and/or other forms of direct and indirect payment to politicians are also included this classification.

### **3.2 Overview of Crony Capitalism**

The term “relationship capitalism” or “crony capitalism” describes the close linkages between the state and big business. Politically-connected firms receive preferential treatment by virtue of their political ties, thus strengthening their competitive advantage (Kali, 2001); rent seeking, extraction and protection are their primary motives and strategies (Shleifer and Vishny, 1997; Agrawal and Knoeber, 2001). Politically-inspired involvements may take diverse manifestations and are summarized in the Table 3.1.

Crony capitalism in East Asian states emerged as a major structural feature when the developmental state model, premised on active state intervention to initiate rapid industrialization, was adopted (Johnson, 1982; Amsden, 1989; Wade 1990; Woo-Cumings, 1999). In this model, government-sponsored industries were channelled a variety of rents in order to help them catch up and compete with their Western competitors. Late arrivals lacked “the comparative advantage of new, innovative products and processes” necessitating government intervention (Amsden, 1994: 631). The infant-industry model was cited to protect and nurture industries until they attained international scale and standards of production efficiency to compete globally. However, such state intervention inevitably also fostered the emergence of politically-connected firms.

Table 3.1

## Politically- inspired intervention

	<b>Forms of Intervention</b>	<b>Source</b>
1	Favourable regulatory settings	Agrawal and Knoeber, 2001
2	Cut-rate credit and import licenses	Mobarak and Purbasari, 2006
3	Capital controls	Johnson and Mitton, 2003
4	Retarding financial development	Rajan and Zingales, 2003
5	Financial bailout	Faccio et al., 2006
6	Preferential access to debt financing	Khwaja and Mian, 2005 Gomez and Jomo, 1997 Claessens, Feijen and Laeven, 2008
7	Preferential bank loans	Sapienza, 2004; Khwaja and Mian, 2005
8	Higher leverage ratios	Faccio, 2002; Johnson and Mitton, 2003; Khwaja and Mian, 2005
9	Lower taxation and greater market power	Faccio, 2002
10	Lower debt cost	Cheny et al., 2011

Among such prominent politically-connected corporations are the *chaebol* in South Korea, comprising independent firms that evolved into large conglomerates through the award of state rents and through preferential price protection to “compete” with foreign products in the Korean market (Amsden, 1990). In Taiwan, government and business are linked through indirect control of companies by ruling political parties, specifically the Kuomintang (Claessens et al., 2000).

The interventionist state model enabled close relationships to evolve between political elites in government, bureaucracy and the business class (Johnson and Mitton, 2003). Business and politics were intertwined and indispensable to each other and widely seen prior to the emergence of democracy in the region from the mid-1980s (Gomez, 1990). After this period, the business elite emerged as prominent political figures especially in



Thailand, South Korea and the Philippines. In other contexts, the business class would be heavily dependent on the political elite for access to public resources, such as government projects, licences and privatized rents, prevalent in many Southeast Asian countries, including Malaysia and Indonesia. The political elite, in return, extracted campaign funding from the business class to enable re-election as was prevalent in many East Asian economies. These two groups tended to defend and mutually support each other synergistically, especially against competitive intrusions and threats. Grossman and Helpman's (1992) model postulates that political actors "sell" protection in return for campaign contributions from the business sector, thus fostering fraud and corruption and the license for businesses to act above the law.

In the economics and finance literature, political links are also referred to as political rent-seeking behaviour rather than illegal transactions as it is legal in many countries (Morck and Yeung, 2003). Political connection reflects a situation where at least a top company officer, large shareholder, or their relatives, were or are either holding a high political office or are prominent politicians (Faccio et al., 2006). Political connections and networks constitute significant and unique managerial resources in transitional economies in general and in Asia in particular (Li and Atuathene-Gima, 2001).

This crony capitalism model saw the rapid emergence of major well-diversified enterprises deriving government-generated rents because of their political linkages (Kali, 2001). Buchanan (1980: 3) defined such rents as "that part of the payment to an owner of resources over and above that which those resources could command in any alternative use." Bhagwati (1982) argued that while rent-seeking behaviour is not necessarily illegal, unethical or immoral, accountability has been given short shrift. Krueger's (1974) perspective is that such behaviour can be "directly unproductive" in

wasting resources and promoting economic inefficiency. Rents are unproductive when they are spent in resource reallocation rather than resource creation (Buchanan, 1980).

### **3.3 Costs and benefits of political connections**

#### **3.3.1 Benefits of political connections**

Chaney et al. (2011) suggest that political linkages enable the “systematic exchanges of favors” between politicians and corporations as the former enhance their value. Corporations develop an advantage from support from the state in the form of tariffs imposed on industry rivals, reduced regulatory requirements or being awarded prized government deals (Goldman et al., 2009). For example, Khwaja and Mian (2005) explored the role of former politicians in facilitating government bank loans to politically-linked corporations in Pakistan while Mobarak and Purbasari (2006) discovered that Indonesian corporations linked to the Suharto regime systematically profited from import licenses at the expense of their competitors. Faccio et al. (2006) have found that governments are also more likely to bail out politically-connected firms.

#### **3.3.2 Costs of political connections**

Despite the benefits associated with politically connections favored enterprises, agency and governance issues may harm such firms. In benefiting from political connections, Schleifer and Vishny (1994) perceive that state-owned firms substitute efficiency and profitability with government-imposed preferences in diverse ways: excessive employment, production of goods determined by politicians and not consumers, operations located in politically motivated and not economically attractive constituencies, below marginal cost pricing and other practices benefiting politically significant individuals or institutions.

Expropriation by the controlling owners, mostly through self-dealing and tunneling, is more apparent in politically-connected firms (Qian et al., 2011). This is supported by findings by Chaney et al. (2011), who discovered that globally such firms report lower quality earnings. Chaney et al.'s (2011) findings are consistent with studies by El Ghouli et al. (2011) and Guedhami and Pittman (2006) on the link between lower quality accounting information and expropriation activities. Chaney et al. (2011) also assert that politically-linked corporations have low managerial drive and concerns.

Chen et al. (2010) have identified proof of information asymmetry complications specifically in the less precise forecast by analysts about politically-connected firms. Although no clear trends exist in the political connection-company performance link, post-IPO stock returns and sales growth of privatized firms in China with politically-connected CEOs underachieve compared to those lacking this relationship (Chen et al., 2010). Bertrand et al. (2008) observe that politically-linked French companies show lower profits than non-linked companies.

In conclusion, information asymmetry concerns, rent-seeking activities of political actors, and prospective expropriation by the controlling shareholders rank among the leading governance concerns confronting politically-linked corporations. Generally, while there exists evidence of the benefits and costs of political connection, only a robust cost-benefit analysis would reveal the precise influence of political connections on shareholders' affluence, production growth and cumulative domestic capital.

### **3.4 Performance of Politically-Connected Companies**

The influence of political connections on the corporation's value continues to be ambiguous and inconclusive. Bertrand et al. (2007) argue that the relationship is negative, Bukanwanicha and Wiwattanakantang (2008), on the other hand, argue that it is positive. Political connections theoretically restrain business growth since they induce inefficiencies (Shleifer and Vishny, 1994) with firms possessing stronger connections having a higher possibility of a bailout (Faccio et al., 2006).

Political connections have an adverse influence on corporate governance and affect corporate transparency perceptions (Bushman et al., 2004). Cronyism can also create an entrepreneurially weak, ersatz capitalism (Yoshihara, 1988) while political intervention can debilitate managerial practices and company performance (Fan et al., 2007). The costs of political involvement on corporate undertakings are more damaging when institutional constraints are poor (Shleifer and Vishny, 1994; Hellman et al., 2003) or legal protection against political expropriation is weak (Acemoglu and Johnson, 2005). The McKinsey Emerging Market Policymaker Opinion Survey on Corporate Governance (2001) reports that politicians constitute a major obstacle to corporate governance reforms.

The net benefits from political connections may not significantly contribute to a firm's economic advantage as they have lower rates of returns on assets than non-connected firms (Bertrand et al., 2004; Chen et al., 2004). Political connections do not necessarily enhance firm efficiency but fulfil politicians' goals. In Malaysia, the evidence on profitability performance, investment and financing decisions of the politically-connected Bumiputera business groups were higher based on market adjusted returns

due to their preferential treatment and tendency to venture into profitable projects (Fazilah, 1996).

While Mitton (2002) contends that Asian corporations with superior disclosure performed better during the AFC, Leuz and Oberholzer-Gee (2003) postulate that Indonesian politically-linked firms prefer state-owned bank financing rather than private sources requiring greater transparency and compliance. According to Bushman et al. (2004), political involvement affects financial transparency in two ways. Firstly, connected firms may suppress firm-particular data to conceal expropriation actions by politicians and their cronies (Bushman et al., 2004); secondly, politicians abuse their authority over regulatory guidelines to favour cronies in return for kickbacks, nepotism and political funding (Bushman et al., 2004).

Other studies identify the earnings opacity of politically-connected firms referring to a measure reflecting the paucity of earnings data and its accurate, but non apparent, economic show (Bhattacharya et al., 2003). Such a strategy weakens external monitoring and maintenance of transparency because of information asymmetries among the corporate insiders and outsiders. Earnings opacity is positively related to the extent to which listed firms are politically connected (Riahi-Belkaoui, 2004). However, it can be lower because of regulatory enforcement and market capitalization of politically-linked corporations.

### **3.5 Development of Politically-Linked Companies in Malaysia**

Although broad accounting and regulatory environmental commonalities prevail in developed economies (US and UK), the Malaysian corporate sector operates in an environment favouring well-connected corporations (Gul, 2006). Political influence exerts a significant role in its capital markets and business dealings. Between 1997 and 2002, there were 81 politically-linked corporations in Malaysia, second only to Britain's 118 (Faccio et al., 2006). Given its capital market size, there is a disproportionately high number of politically-connected firms in the country. Based on studies by Gomez and Jomo (1997) and Searle (1999), these firms were represented in major economic sectors and comprised about 30 per cent of Bursa Malaysia's 757 companies and exceeded 20 per cent of its total market capitalization.

There are three distinct types of politically-connected firms in Malaysia. The first are companies that are directly state-owned and managed, termed government-linked companies (GLCs), where the state owns at least 20 per cent of the issued and paid-up capital (Treasury Circular, Ministry of Finance, 1993). The state has considerable ownership in many public-listed companies, directly or indirectly, through government-linked investment companies (GLICs), such as Ministry of Finance Incorporated (MoF Inc), Khazanah Nasional Berhad, Perbadanan Nasional Berhad (PNB), Employees' Provident Fund (EPF), Lembaga Tabung Angkatan Tentera (LTAT), Pilgrimage Fund Board (TH) and Tabung Amanah Kumpulan Wang Pencen (KWAP) (Treasury Circular, Ministry of Finance, 1993). Supervisory boards administer these funds while their investment strategies are controlled by the government. The GLCs and their controlling shareholders, the government-linked-investment-companies (GLICs), constitute a significant part of the nation's corporate structure. GLCs dominate such key strategic

utilities and services as banking and financial services, telecommunications, electricity and airlines (PCG, 2006).

The second type of politically-linked companies are those directly and/or indirectly owned by political parties within the ruling coalition, the Barisan Nasional (Gomez 1990)<sup>12</sup>. Two parties, in particular, that is the hegemonic United Malays National Organization (UMNO) and the Malaysian Chinese Association (MCA), the most senior members of the Barisan Nasional, own a vast array of key private and publicly-listed companies. By 1995, about 16,000 companies had been established by UMNO's divisions, branches and members, usually proxies for the party (Mauzy and Barter, 2008). However, due to the complicated ownership structures of these firms as well as proxy ownership, the extent of business ownership by political parties today is difficult to estimate. Prior to the AFC, the Malaysian corporate scene was dominated by corporations owned directly or indirectly by UMNO, such as the well-diversified Renong, the infrastructure construction-based United Engineers Malaysia (UEM) and the holding company, Realmild, which owned leading media enterprises. What is clear, based on the annual reports of publicly-listed firms, is that UMNO has a majority stake in the company that publishes the leading Malay-based newspaper, *Utusan Malaysia*<sup>13</sup>, while the MCA owns Star Publications, the enterprise that publishes *The Star*, the best-

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<sup>12</sup> Malaysia remains one of very few countries where political parties own a range of business interests; the others include Ethiopia, the Czech Republic and Austria. In Taiwan, the Kuomintang (KMT) had ownership and control of a vast array of firms, including banks, which it reputedly divested after losing power in 2000 in an attempt to clean up its image as a party deeply mired in conflict-of-interest situations and the practice of patronage that had led to corruption.

<sup>13</sup> UMNO has indirect control of a major English newspaper, *The New Straits Times*, the Malay-based tabloid, *Berita Harian* and major television channels such as TV3 and NTV7.

selling English newspaper. The leading Chinese newspapers are owned by the Tiong family of Sarawak whose members are closely aligned with the Barisan Nasional.<sup>14</sup>

The third set of companies are owned by well-connected businessmen (Johnson, 2001), with the state playing the role of patron, protector and nurturer. Such companies are typically one-man or family-run companies (Thillainathan, 1999, Claessens et al., 2000) whose owners participate directly in their management (Khatri et al., 2003) and which may have significant government equity holdings (Abdullah, 2006). The prevalence of such politically-connected companies reflects the intimate interpersonal ties formed by some multi-ethnic business people with powerful political leaders, especially from UMNO<sup>15</sup>.

The growth of politically-connected firms and the close political-business elite links are outcomes directly associated with the nature of public policies introduced by the Barisan Nasional-led government. In particular, such political business links were fostered by the New Economic Policy (NEP) in 1970 and through the privatization policy that was actively pursued from the mid-1980s (Gomez and Jomo, 1997).

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<sup>14</sup> The Tiong family has a major interest in the Media Chinese International Ltd which has ownership of Malaysia's best-selling Chinese newspapers, the *Sin Chew Jit Poh* and the *Nanyang Press*.

<sup>15</sup> See Gomez (1994) and Searle (1999) for comprehensive accounts of the rise of well-connected companies, including those owned by political parties.



### **3.6 New Economic Policy (NEP)**

The major determinant of the prevailing political influence in the corporate sector was the New Economic Policy (NEP) (Khoo, 2004) initiated under the Second Malaysia Plan (SMP)<sup>16</sup> in 1971 to redistribute wealth more equally among the nation's diverse ethnic communities (Hensley et al., 1993). In restructuring society, one objective was to increase Bumiputera participation in an economy dominated by the Chinese and foreigners (Hensley et al., 1993). Ultimately, it anticipated the Bumiputera businessmen partnering with other Malaysian ethnic groups in the nation's economy with the latter and foreigners owning 40 per cent and 30 per cent, respectively, of national wealth by 1990. It also aimed at 30 per cent Bumiputera corporate ownership through partial abandonment of the laissez-faire style of economic management in favour of ethnic affirmative action.

The NEP provided an overarching policy framework that pre-supposed effective policy making capabilities, determined state economic intervention, bureaucratic regulation, and governance modes generally associated with the East Asian developmental state (Khoo, 2004). According to Bowie (1988), in launching the NEP, the government played an interventionist role in the economy by establishing numerous business initiatives and joint public-private companies. Massive state resources flowed to such state bodies such as the Council for the Advancement of Indigenous Races (MARA), Perbadanan Nasional Berhad (PERNAS), Urban Development Authority (UDA) and the thirteen State Economic Development Corporations (SEDCs). All have later become Bumiputera economic enterprise prototypes under the Second Malaysia Plan (Abdullah, 1992). Alongside the NEP, the state announced other ethnically-oriented policies to achieve the 30 per cent Bumiputera corporate ownership target by 1990.

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<sup>16</sup> The Second Malaysia Plan was carried out between 1971 and 1975.

Since the NEP's introduction, Bumiputera have been given preferential treatment in business deals, access to resources and other supports (Johnson and Mitton, 2003). Apart from promoting Bumiputera corporate ownership with relaxed financial credit, the state initiated Bumiputera trust agencies to secure ownership and equity on behalf of the Malays to achieve the NEP objectives (Mehmet, 1988). Such public enterprises were pioneers in the government's drive to increase Bumiputera corporate participation though it simultaneously fostered and nurtured political-business linkages.

The NEP has exerted a profound structural transformation of the economy effectively substituting European-Chinese capital ownership dominance with Chinese-Bumiputera dominance; also, private ownership existed alongside state and quasi-public body ownership of the corporate sector (Sieh, 1980). By the 1980s, government intervention in the corporate sector was represented in the GLCs, the wholly-owned state enterprises and their joint-ventures with privately-owned companies. Such policies created the environment for extensive political involvement in business and motivated businessmen to cultivate political links (Johnson and Mitton, 2003; Gul, 2006).

### **3.7 Privatization Policy**

The second form of political business resulted from political favouritism displayed in the cultivation of informal, non-race-based ties of selected firms with the political elite (Gale, 1985; Gomez, 2000); this was political patronage in a form different from the country's "relationship-based" capitalism which, to Fraser et al. (2006), comprises three overlapping components, economic, social and personal, all mutually reinforcing.

Mahathir Mohamad's accession as Prime Minister in 1981 was a watershed moment in relationship-based capitalism in the country. To accelerate the pace of Bumiputera ownership, Mahathir pushed for a network of dynamic, entrepreneurial Malay capitalists to control large corporations (Gomez, 2004)<sup>17</sup>. During the 1980s and early 1990s, a number of businessmen emerged with intimate relations to the political elite and promptly progressed, primarily through rents obtained from the privatization policy (Gomez, 2004; Johnson, 2001).

The state has also gradually assumed the role of political patron and intervened overtly through control of the banking sector and "institutional" investors<sup>18</sup> (Gomez and Jomo, 1997). Using their political influence, politically-affiliated business groups enjoyed preferential access to state-controlled loans to finance projects (Yoshihara, 1988) and became very successful. Subsequently, many were later listed on Bursa Malaysia.

Mahathir's objective to nurture home-grown capitalists in the stock market was spurred by his privatisation policy and a second tier market with less stringent listing requirements<sup>19</sup> in the early 1980s; 401 companies were listed between 1984-1996 on the main and second boards. By the mid-1990s, Bursa Malaysia was ranked the third largest in the Asia Pacific after Hong Kong and Sydney, in terms of attracting foreign

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<sup>17</sup> In the mid-1970s, not one of the country's top 100 firms was owned by the Malaysian government or Bumiputera individuals (Lim, 1981). Mahathir sought to rectify this as he saw it as a major anomaly in wealth ownership patterns.

<sup>18</sup> The Employees' Provident Fund (EPF), Armed Forces Fund Board (LTAT), Permodalan Nasional Berhad (PNB), Lembaga Tabung Haji (LTH) and Social Security Organization (SOCSO) collectively represent approximately 70 per cent of total institutional shareholdings in corporations listed on the Bursa Malaysia's Main Board (Wahab et al., 2007).

<sup>19</sup> Under the New Bursa Malaysia Listing Requirements (2001); to be listed on the Main Board, a company must possess at least RM60 million. For the Second Board, at least RM20 million is required. (*Bursa Malaysia Annual Report, 2001*).

investors. Domestic investors were increasingly attracted by the Initial Public Offerings (IPOs) that were often over-subscribed.

Allegations of extensive political nepotism and cronyism paralleled the implementation of the privatisation policy (Gomez and Jomo, 1997), attributable primarily to the absence of an autonomous, accountable governance agency to ensure transparency and enforcement. A significant increase ensued in the prevalence of fraud, bribery, asset stripping, favouritism and misuse of corporate power since the late 1980s and the early 1990s (Gomez and Jomo, 1997). A majority of large corporate scandals as traced to the failings of internal control and corporate governance systems (Abdul Samad, 2002).

### **3.8 Asian Financial Crisis (AFC)**

Thailand's stock market collapse in June 1997 pre-staged similar meltdowns in the stock markets of the Philippines, Indonesia, Malaysia, Singapore and South Korea later that year (Clarke, 2004). Bursa Malaysia's collapse was spectacular: between July 1997 and January 1998, the Malaysian Ringgit plummeted almost 50 per cent against the United States dollar<sup>20</sup>. By September 1998, Bursa Malaysia lost over 65 per cent of its market capitalization, wiping out almost US\$225 billion while the composite stock index fell by up to 79.3 per cent from a high of 1271.57 points in February 1997 to a low of 262.70 points on 1 September 1998 (Ragayah 2003).

A crippling loss of foreign investor confidence in Malaysia resulted primarily because of the dismal public and private corporate governance standards. Businesses suffered

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<sup>20</sup> The ringgit was valued at RM2.50=U.S\$1.00 in July 1997, the value depreciated to RM4.88=US\$1.00 by January 1998.

from a widespread perception of poor ethical standards, credit ratings were downgraded, share prices were emaciated, debt restructuring was protracted and new project financing became onerous and expensive. The AFC saw a near collapse of the nation's leading publicly-listed companies shouldering heavy debt loads, over-leveraging and dismal due diligence during mergers and acquisitions. Many Bumiputera-owned enterprises went bankrupt while others had to be put on government bailout and rescue package life support (Gomez, 2004:3).

The World Bank (1998:57) observed that “the poor system of corporate governance has contributed to the present financial crisis by shielding the banks, financial companies, and corporations from market discipline”. It continued as follows:

*“Corporate governance in East Asian countries has been characterized by ineffective boards of directors, weak internal control, unreliable financial reporting, lack of adequate disclosure, lax enforcement to ensure compliance, and poor audits. These problems are evidenced by unreported losses and understated liabilities. Regulators responsible for monitoring and overseeing such practices failed to detect weaknesses and take timely corrective action”*  
(World Bank, 1998:67-68).

Governance issues such as lack of accountability, corrupt business practices and weak corporate governance have been also been associated with the crisis (Backman, 1999; Noordin; 1999; Nam and Nam, 2004; Suto, 2003; Mitton 2002). The complicit East Asian firms exhibited over-leveraging, concentrated ownership, centralized family control and expropriation of minority shareholders' interests exacerbating diffuse corporate governance and impeding legal and regulatory developments (Claessens et al., 1999).

Crucially too, managerial agency challenges caused economies with poor regulatory framework to become vulnerable to the incidences of a rapid withdrawal by investors. The stock market decline in 1997/98 has long been associated with poor corporate governance mechanisms and weak protection of minority shareholder rights. Johnson et al. (2000) argue that corporate governance may constitute the primary determinant of the extent of macro-economic problems in crises.

### **3.9 Performance and Role of Politically-Linked Companies**

The East Asian politically-linked companies and relationship-based business culture were significant determinants of the AFC (van der Eng, 2004) together with pervasive corruption and cronyism. According to Greenspan's (1998) structural theory, state-directed capitalism, as in the East Asian countries, was structurally weak and had deep-rooted institutional deficits; in effect, the AFC crisis was emblematic not so much of market failure as institutional failure associated with underdeveloped governance mechanisms (IMF, 1999). Thus, the advocates of the "Fundamentalist View" argue that the AFC can be traced to structurally unsound domestic financial institutions (Corsetti et al., 1998).

Faccio et al. (2006) argue that there exists documentary evidence of the pervasive network of politically-connected companies in Malaysia. These firms absorbed greater post-crisis shocks than other corporations due to their inherent inefficiencies and excessive leveraging (Bongini et al., 2000) and the state's initial inability to rescue them (Johnson and Mitton, 2003; Gomez, 2004; Faccio, 2006).

High-profile cases of poor corporate governance by politically-linked firms undermined market sentiment and exacerbated the crisis (Liew, 2007). While numerous Malay-owned enterprises collapsed, a select few survived solely through government bailouts (Gomez, 2004) together with a series of asset-stripping transactions and ambiguous and opaque reforms. Examples include Renong Berhad's merger (and bailout) by United Engineers Malaysia Berhad (UEM) in 1997, Petronas's acquisition (and bailout) of Konsortium Perkapalan Berhad (KPB) in 1998 and the Koperasi Usaha Bersatu Berhad's (KUB) purchase (and bailout) of Sime Bank assets in 1999.

To Johnson and Mitton (2003), the government's capital control policy in 1998 was principally proposed to assist politically-connected firms. Government intervention extended to the nationalization of companies owned by such crony businessmen as Halim Saad, Tajudin Ramli and Mirzan Mahathir in a retrogressive corporate governance strategy that discounted and neglected the interests and welfare of minority shareholders.

### **3.10 Conclusion**

This chapter has examined politically-linked companies stressing the development of crony capitalism and its relationship with the state. It underscores the evolution of politically-linked companies in Malaysia, drawing attention to the in different forms and their inherent corporate governance weaknesses. Chapter 4 will examine the evolution of corporate governance reforms worldwide and in Malaysia in particular.

## **CHAPTER 4**

### **CORPORATE GOVERNANCE REFORMS**

#### **4.0 Introduction**

This chapter provide a broad overview of corporate governance reforms in such key global economies as the United States of America, United Kingdom, Australia and the emerging economies in aggregate is provided before analysing the initiation and nature of governance reforms in Malaysia, post-AFC.

#### **4.1 Overview of Corporate Governance Reforms**

The 2008 Global Financial Crisis (GFC) and the well-publicized misadventures of large corporations (for instance, AIG and Lehman Brothers) have, unsurprisingly, triggered a re-examination of the state's role in safeguarding the public interest through more efficacious regulatory frameworks. Governments worldwide have been compelled to pay the agency cost of monitoring and disciplining wayward corporations through publicly-funded bailout payments, plunging government budgets into serious deficits.

The prevalence and recurrence of large-scale corporate scandals have continued unabated despite cyclical regulatory reforms, a fact reflecting their limited efficacy. Such challenges, unfortunately, are not new, unique or unwitting but have become cyclical in nature, as corporate governance policies, structures and practices have borne repeated and extensive scrutiny, controversy and debate (Gugler, 2001).



Such recurrent phenomena are universally attributed to inherently weak regulatory frameworks exacerbated by inconsistent and diffuse enforcement in addressing blatant corporate misbehaviour (van Apeldoorn et al., 2003; Kirkpatrick, 2009). The intensive re-appraisal of prevailing existing corporate governance institutions, frameworks and mechanisms alongside empirical research has become a reflexive outcome of the financial crisis. Numerous studies (Vinten, 2002; Boyd, 2003; Leung and Cooper, 2003; Mardjono, 2005; Petra, 2005) conducted on the more spectacular cases have converged on governance, ethical and integrity issues.

A multiplicity of regulatory and policy changes have been enacted globally, illustrated by the Cadbury Code, 1992, Sarbanes-Oxley Act, 2002, OECD Principles of Corporate Governance, 2004 and the Review of Combined Code, to consolidate enterprise governance, transparency and accountability (Bhagat and Bolton, 2009). It was naively anticipated that such reforms would prevent global financial crises as more stringent accounting and regulatory standards (Kirkpatrick, 2009) were put in place to protect investors and create more efficient capital markets (Patelli and Prencipe, 2007; Fabrizio and Antonio, 2007).

The global financial crisis has drawn attention to a multitude of corporate scandals, managerial expropriation of shareholders' wealth, false reporting, non-disclosures of accounting and governance practices, insider trading and fraudulent practices precipitating yet another governance outcry. Global bodies, governments, researchers, practitioners and professional bodies have engaged in numerous studies and debates on diverse topics including corporate governance structures, systems and practices, governance models, legal structures, independent non-executive directors, corporate

governance and corporate performance, and convergence and divergence of best practices.

The structuring of national governance policies must be preceded by conceptualizing the governance problem confronting a specific nation (Berglof and Claessens, 2004) which Clarke (2007) postulates diverges with time, history, culture and economy. Prowse (1998) elaborates by associating effective corporate governance mechanisms with a competitive environment, legal protection for external capital, ownership structures and financial contracts. The Business Sector Advisory Group on Corporate Governance (OECD, 1998:4) report acknowledges that regulatory frameworks essentially “shape a corporate governance environment compatible with societal values, which allows competition and market forces to work so that corporations can succeed in generating long term economic gains.”

#### **4.2 Global Corporate Governance Systems**

Corporate governance reforms have led to multifarious models fostering a corporate structure shaped conventionally on a legislative-political framework (Shleifer and Vishny, 1997). Good corporate governance could normatively sustain businesses as going concerns by promoting transparency, accountability, integrity and efficiency while enabling symbiotic stakeholder linkages (Mardjono, 2005).

Corporate governance reforms invariably appear as Corporate Governance Codes and Guidelines on Best Practices; the prime examples emanate from the United States of America, United Kingdom, and Australia. The pioneering Cadbury Code (1992) has been a seminal source for company board structures and accounting systems to check systemic corporate governance hazards and catastrophes. The Cadbury Report was

succeeded by the Greenbury Report (1995), Hampel Report (1998), Smith Report (2003) and Higgs Report (2003). These reports were subsequently consolidated into the Combined Code 2003 and the current Combined Code 2006 (Danker, 2008).

Most emerging nations now possess corporate governance codes, including Indonesia, China and Thailand, with Malaysia being the first East Asian economy to design a personalised variant (Roche, 2005). While not all national codes and regulations are similar, their prescriptive and normative strengths are contained in the sections on enhancing board governance quality, shareholder accountability and governance environments and contexts (Bhagat and Bolton, 2009).

Scholars argued that the diverse global corporate governance systems materialized in an impromptu manner (Shleifer and Vishny, 1997; Sison, 2000) shaped by conventions, environment and worldview (Sison, 2000:181) further argues that “culture, democratic representation and accountability, the distribution of power, and the protection of property rights and equality” play a significant role. The level of media freedom and business competition are other crucial factors (Zingales, 2000). The vital point in the development of various national corporate governance systems is that these systems are not specifically designed to attain optimum efficiency, economic welfare or shareholder security.

Roe (1994) proves that in the United States, whose laws actively discourage large investors from gaining any tangible control on companies. Thus, the distinctive small shareholder protection in the United States is reflected in the suppression of large investors (Bhide, 1993; Coffee, 1991) making this country’s system far from efficient (Roe, 1994).

Gerschenkron (1962) argues that this concept applies equally to the insider systems of Germany and Japan whose accelerated economic growth in the late nineteenth century consolidated a system of powerful banks with support from the state. Furthermore, German banks forswore such initiatives as heightened minority shareholder protection, insider trading proscriptions and disclosure rules ensuring their virtual suppression while ascertaining their own dominant status.

An assessment of the evolution of national corporate governance systems provides insights into the complex issues shaping the process of corporate governance. Multifarious forces, often conflicting with one another, affect the process influencing the optimal corporate governance system. In emerging and transitional economies, in particular, such determinants generate multiple policy connotations.

The United States, United Kingdom, Germany and Japan provide examples of the finest global corporate governance systems and whose mature market economies have confronted governance challenges more effectively and resolutely than many other countries. This, however, does not imply that their systems are impeccable and do not require upgrading. In contrast, the systems in emerging and developing economies are essentially non-existent (Shleifer and Vishny 1997) and clearly have a steep learning curve to traverse, primarily attributable to the quality of their primary institutional framework.

#### **4.2.1 United States of America**

A combined prevalence of extensive market manipulation, insider trading, corporate misconduct and a blatant disregard for shareholder rights brought on the 1929 Wall Street crash and the Great Depression. A knee jerk reaction was Congress' introduction of the Securities Act 1933 and the Securities and Exchange Act 1934, which aimed to resolve such manipulations and enhance transparency principally by regulating corporate financial disclosures. Governance failure in the late 1980s resulted in a predictably similar policy reaction by the United States. The corporate reforms led to a policy focus on corporate board quality and impartiality while a group of influential institutional investors emerged (Iskander and Chamlou, 2000).

In 2001, because of Enron became the biggest insolvency in corporate history of the United States and was disastrous as its employees' pension funds were invested in its stock, not to mention other public and institutional investors. Enron provided a surreal and unparalleled exhibition of bookkeeping creativity and deception, regulatory miscarriage, managerial excess and needless bankruptcy, ultimately forcing Congress to enact the Sarbanes-Oxley Act (2002). The Act addressed the establishment of a public company accounting oversight board and punitive regulations impinging upon auditor objectivity, corporate obligation, accounting disclosure and controls, conflicts-of-interest, and corporate deception (Banks, 2004).

Enron's collapse dramatically underscores the primacy of proper corporate governance, necessitating rigorous monitoring and supervision through checks and balances in its controlling and monitoring mechanisms (Solomon and Solomon, 2004). While unable to avert unscrupulous actions by senior personnel, such mechanisms constitute a powerful detection tool, provided they are consistently enforced.

On the whole, the United States' commitment to achieving good governance is unquestioned (Kiel et al., 2004), and is reflected in the other landmark documents and legislation including the Report of the NYSE Corporate Accountability and Listing Standards Committee, Report of the NACD Blue Ribbon Commission on the Role of the Board in Corporate Strategy.

Holderness' (2002) examination of United States equity ownership by insiders (i.e. a firm's officers and directors) and block-holders (ownership of at least 5 per cent of equity), shows that the typical inside ownership in publicly-traded American corporations is approximately 20 per cent, varying from almost nil to majority ownership by insiders. This supports Denis and McConnell (2002) study that publicly-traded firm ownership is significantly more concerted in other countries than in the United States, and appears to impact corporate value positively. There are more noteworthy private advantages of control in many countries than the United States; structures that enable control rights exceeding cash flow rights are typical and reduce the value of the firm.

United States' boards of directors include some of the very insiders who are to be observed and, additionally, often Chief Executive Officers (CEOs) who act as board chairs. Board member selection is strongly biased as management virtually determines board nominees. Board composition parameters consistent with good governance practices include its size and structure, number of members, proportion of outside directors and whether one person is assigned the chief executive and board chair designations (Denis and McConnell, 2002).

#### **4.2.2 United Kingdom**

The first crisis of governance recorded in the United Kingdom is the 1720 South Sea Bubble. The crisis forced the United Kingdom to enact corporate statutes to shield the public from such manipulations by guaranteeing shareholders' privileges to material and the capacity to engage and dismiss company directors and auditors (Iskander and Chamlou, 2000). A series of financial scandals and collapse of prominent corporations in the late 1980s, including Marsh & McLennan Companies (MMC), Bank of Credit and Commerce International (BCCI) and Polly Peck, led to the establishment of the 1990 Cadbury Committee.

The Cadbury Report identified the board as a prime corporate governance mechanism. Given its oversight role of the management of companies, Solomon and Solomon (2004) argue that directors must be vigilant in monitoring and assessment, while the accounting and auditing task of a firm had to be transparent to shareholders and other stakeholders. The report attained considerable status and authority not only in the United Kingdom but in many other countries (Clarke, 2004).

Further corporate governance reforms followed on specific corporate governance mechanism, including director remuneration guidelines (Greenbury Report, 1995), disclosure and best practices (Hampel Report, 1998), mandatory disclosure framework (Combined Code, 1998), and mandatory disclosure (Turnbull Report, 1999). Other have focused on the Recruitment and Development of Non-executive Directors (Tyson Report), role and effectiveness of Non-executive Directors (Higgs Review), Audit Committee Combined Code Guidance (Smith Report), and Internal Control: Guidance for Directors on the Combined Code (Turnbull Report) (Kiel et al., 2004).

Investigating the board's oversight in hiring and firing top management presuming a performance-efficacy and their turnover-corporate failure links before and after the Cadbury Report (1992), Dahya et al. (2002) discovered that increases in the sensitivity of management turnover to corporate performance, consistent with the Report's impact on board oversight quality. Contrastingly, Franks et al. (2001) established that boards subjugated by outside directors could essentially obstruct the correcting of underperforming administration.

#### **4.2.3 Australia**

The corporate governance framework in Australia is a combination of common law principles, legal regulations governed by the Corporations Act 2001, and self-guidelines under the Australian Stock Exchange (ASX) Listing Rules mandating corporate governance practices disclosure. Studies on its corporate governance system find that, with a fairly dispersed capital market, corporate governance constitutes a central role (see Mallin, 2006). If investors are generally mobile with their investments, company directors tend to act in the shareholders' interests thus enhancing shareholder value (Keong, 2002).



The two major Australian corporate failures, OneTel and HIH Insurance, did not perturb the state, as more bankruptcies were not expected because of the robust and long-standing disclosure requirements. This notwithstanding, corporate governance has been the centrepiece of reforms in Australia. Firstly, in 2002, the state introduced new disclosure requirements under the Australian Corporate Law Economic Reform Program (CLERP 9) (Clarke, 2004). Incorporated into the Corporations Act, CLERP 9 provides for the implementation of accounting principles and regulatory requirements such as the Australian Prudential Regulation Authority (APRA).

Next, “Standards Australia” published its “Good Governance Principles” (AS 8000-2003) covering director independence, board structure and board expertise and experience. Thirdly, in 2002, the ASX created the ASX Corporate Governance Council comprising representatives from multiple organisations concerned with corporate governance (Kiel et al., 2004). The Council published the Principles of Good Corporate Governance and Best Practice Recommendations (ASX guidelines) in 2003 to encourage boards to proactively enforce effective corporate governance. In 2004, the Implementation Review Group (IRG) was created to observe corporate evolution in application codes and principles (Kiel et al., 2004).

#### **4.2.4 Emerging Economies**

Attention to policy pertaining to corporate governance has long been more focused in developed market economies compared to those in emerging economies. However, the AFC has forced corporate governance reforms in the latter into the public arena.

The corporate governance literature concerning transition economies has customarily focused on the differing interests of dispersed shareholders against self-motivated executives. Nevertheless, La Porta et al. (1999) have revealed that such an ownership pattern is only associated with countries having comprehensive investor protection as in the United Kingdom and United States, and is not global; also, it is presumed that specific institutional frameworks, like an effective civil or common-law justice system exists which is lacking in most emerging nations (Berglöf and von Thadden, 2000). This makes generalization of mature economies' corporate governance policies and guidelines not fully applicable in emerging economies facing dissimilar challenges, priorities and solutions. These countries then have to explore alternative and more appropriate governance models.

Emerging economy corporations tend to use internal rather than external resources to fund expansion projects as the risk premium for outside investment are often great due to weak investor safeguards, enforcement and transparency (Fama and French, 1989). Internal funding can be scarce, however, and constrain firm growth (Perotti and Gelfer, 2001) although this can lessen inter-firm transfers in a corporate group (Berglöf and von Thadden, 2000), particularly if bank-led (Perotti and Gelfer, 2001). Generally, bank loans provide external capital in emerging economies to fund economic growth (Perotti, 1993). If contemporary investment options are interrupted prior to fresh and dependable options are generated, hasty financial reforms can lead to significant output losses in emerging economies (Blanchard and Kremer, 1997). Thus, corporate and financial reforms must be founded on a basic functioning banking system when equity markets are virtually non-existent. Hence, creditor rights may take precedence over minority shareholders rights in the legal reform context (Carlin and Mayer, 1998; Pistor et al., 2000).

Emerging economies invariably comprise a dominant sector of former state-owned enterprises (SOEs) requiring restructuring while service sector growth, particularly, has to be supported alongside the legacy of a non-functioning legal framework and other rudimentary governance institutions (Berglöf and von Thadden, 2000). The reform issues include weak public and private enforcement of investor protection (Berglöf and Claessens, 2004; La Porta et al., 1998).

Emerging economies also have to deal with soft budget constraints due to the continued refinancing of loss-making SOEs (Berglöf and Roland, 1998; Schaffer, 1998) impeding bank sector growth. This results in inefficient governance structures being maintained with little reform motivation or effort. As tougher budget constraints can likely yield superior investment resolutions, the exclusion of poor plans can enhance the SOEs efficiency and performance.

To alleviate the influence of poor investor protection, emerging economies are inclined to possess rather high ownership concentration (La Porta et al., 1999). This, coupled with weak investor safeguards, impairs the liquidity of equity markets which can provide external financing, “divestiture” and diversify systematic risks. Also, it effectually annuls the market for corporate control, a vital issue in many emerging economies. Even when these economies are rapidly developing, firms issuing equity to raise capital confront poor minority investor protection (Singh, 1995); forgone profitable investment opportunities can lead to enormous social costs (Claessens et al., 1999).

With immature legal and financial frameworks, alternatives for customary corporate governance mechanisms and funding options assume greater prominence. Managers' reputational concerns and capital markets availability shape appropriate corporate behaviour (Shleifer and Vishny, 1997) pending investor protection and governance mechanisms (Gomes, 2000). During that stage, financiers rely on the reputational concerns of managers for their security, which is substituted by legal protection in the longer run. Financing can be accessed in environments with inferior financier safeguards through investor hopefulness about companies driven by immediate share rise prospects (Shleifer and Vishny, 1997); ultimately explaining the massive equity investment pre-AFC.

Corporate governance reforms in the emerging economies must address soft budget constraints, strengthen primary institutions, reduce corruption and protect investors to attract external finance and hasten active and deep restructuring (EBRD Transition Report, 1996). Other central issues identified are public and private sector regulatory enforcement pressure (Berglöf and Claessens, 2004) and sustained state backing for financial restructuring (Dewatripont and Roland, 1997).

### **4.3 Corporate Governance Development in Malaysia**

Since the 1997 Asian Financial Crisis, the Asian Development Bank (ADB), World Bank and OECD have prioritized corporate governance development in emerging nations to underpin investor confidence and driven microeconomic reforms, particularly in the area of governance mechanisms and principal-agent relationship (Jomo, 2004). Iskander and Chamlou (2000) have identified that East Asian governance reforms included closure of bankrupt banks, reinforcement of prudential regulations, liberalization of the banking industry to foreign financiers, overhauling bankruptcy and takeover procedures, tightening listing rules and appointment of external directors.

In the post-AFC period, the Malaysian government, faced with a debilitating loss of foreign investor confidence, instituted a raft of governance reforms (Ho and Wong, 2001). Its key objectives concerned equity and fair play, transparency, accountability and responsibility in corporate behaviour (Abdul Hadi et al., n.d) to revitalize the stock market and its regulatory environment by lessening market vulnerability to future financial crises, property rights reinforcement and reduction of transaction and capital costs (World Bank, 2005).

#### **4.3.1 Finance Committee on Corporate Governance**

In 1998, the High Level Finance Committee (HLFC) was instituted to formulate corporate governance and best practices framework for the capital market (FCCG, 2000). The HLFC, comprising senior government representatives, regulatory agencies, industry bodies and professional associations conducted a review of Corporate Governance Best Practices of Public-Listed Companies aided by Bursa Malaysia and PriceWaterhouseCoopers Malaysia (PWC) (Ow-Yong and Guan, 2000). Stressing the significance of fairness, transparency, accountability and responsibility among capital

market players (Abdul Hadi et al., n.d), it underscored the board's governance monitoring role to boost shareholder value and protect shareholder wealth. Many governance lapses were linked mainly to ownership concentration, board efficacy, shareholder indifference, enforcement mechanisms and poor awareness of the duties of directors (Othman, 1999).

The HLFC recommendations released a progression of regulatory changes through the Securities Commission, KLSE and Registrar of Companies, ultimately establishing the Malaysian Corporate Governance Code (MCCG), Malaysian Institute of Corporate Governance (MICG) and Minority Shareholder Watchdog Group (MSWG).

#### **4.3.2 Malaysian Code of Corporate Governance (MCCG)**

In March 2000, The Malaysian Code on Corporate Governance (MCCG) was ratified. Influenced by the Hampel Report (1998), it favoured a hybrid approach integrating the London Stock Exchange's prescriptive orientation with the Australian Stock Exchange's non-prescriptive approach. The hybrid approach recognized that specific corporate governance behaviour deserved statutory regulation while others were more effectively conditioned by self-regulation complemented by market controls.

The MCCG signified a serious pioneering attempt by regulatory officials and industry players to counter the challenges of a globalised market economy which was undergoing rapid deregulation and liberalisation (Hee, 2003). Adoption of the MCCG was voluntary until January 2001 when listing requirements were revised to make its provisions mandatory and to disclose any noncompliance (Mak and Li, 2001). To make transparency prominent, public-listed companies were obligated to report a statement of corporate governance, composition of the board of directors and audit committee,

declaration of internal control and any additional statements by the board of directors in their annual reports (KLSE, 2001).

In summary, the MCCG essentially prioritized the control side of governance, rather than its direction and strategy, as it stressed disclosures, board attributes and the independent non-executive director, corporate communication and shareholder activism, in particular by institutional investors, and accountability and audit. Board attributes were aligned to the global standards of board independence by including sufficient independent non-executive directors, independent committees and director's compensation and characteristics.

#### **4.3.3 Summary of Malaysian Corporate Governance Reforms**

The Malaysian corporate governance framework has undergone radical redirection, post AFC. Among them are: quarterly disclosures of financial statements, establishment of the MCCG and Minority Shareholders Watchdog Group. Amendments were also made pertaining to whistle-blowing and to improve investor protection mechanisms. These improved the paths for judicial compensation in the Securities Industry Act (SIA) 1983 or Listing Requirement contraventions. Bursa Malaysia announced the Best Practice in Corporate Disclosure for listed firms to observe with disclosure obligations under the Listing Requirements and securities law in 2004. Supplementing the MCCG, the Putrajaya Committee on Government Linked Companies (GLC) High Performance (PCG) presented an outline to promote GLC transformation and promotion of GLC board efficiency by introducing the “Green Book” in 2006.

#### **4.4 Conclusion**

This chapter has reviewed the evolution of corporate governance reforms and the challenges pertaining to the effective implementation of such reforms in the United States, United Kingdom, Australia and Malaysia. While a broad consensus prevails about the concept of good corporate governance, global models of good practice have to be adapted to the evolutionary path adopted in the political economy of a nation or groups of countries. In the emerging or transitional economies, corporate good governance is in its infancy and its effectiveness is contingent upon the nurturing of the primary institutions of a democratic state.



## CHAPTER 5

### RESEARCH METHODOLOGY

#### 5.0 Introduction

This thesis explores the occurrence of corporate scandals involving politically-linked companies in Malaysia despite the corporate governance reforms introduced after the 1997 Asian Financial Crisis (AFC). A qualitative research strategy is applied involving a cross-case analysis to discover common themes connected to business scandals grounded on Sherman's (1978) framework to explore the cyclical nature of corporate governance scandal and reform. In this chapter, the case study approach and its application in this thesis is reversed aligned to the case study design components developed by Yin (2009) followed a discussion of Sherman's (1978) model and the limitations of this methodological approach.

#### 5.1 Qualitative Research Design: Case Studies

Unlike quantitative methods, "qualitative research involves any research that does not indicate ordinal values" (Guest, Namey and Mitchell, 2013:2). The study goal is to gather primary data that is more contextual, covers multiple sources to generate subjective perspectives exceeding the narrowly focused data collected in quantitative surveys.

Thus, qualitative research is "research using methods such as participant observation or case studies which result in a narrative, descriptive account of a setting or practice (Guest, Namey and Mitchell, 2013:2). A more comprehensive perspective given by

Denzin and Lincoln (cited in Guest, Namey and Mitchell, 2013:3) perceives the qualitative research strategy as “a situated activity that locates the observer in the world. It consists of a set of interpretive, material practices that make the world visible. These practices transform the world. They turn the world into a series of representations, including field notes, interviews, conversations, photographs, recordings and memos to the self. At this level, qualitative research involves an interpretive, naturalistic approach to the world. This means that qualitative researchers study things in their natural setting, attempting to make sense of, or to interpret, phenomena in terms of the meanings people bring to them.”

The qualitative research method includes a diversity of approaches including narrative analysis, grounded theory, ethnography, inductive thematic analysis, case study, discourse/conversation analysis, phenomenology and mixed methods drawing both primary and secondary data from multifarious sources including interviews (structured and unstructured), focus groups, participant observation, and record/document/video/film/photography analysis.

Case studies can be utilized for exploratory, descriptive and explanatory investigations and are similar to “case histories” on individuals in psychology and medicine (Hamel et al., 1993; Yin, 2009). The case study approach can enable the examination of one or more cases from multiple dimensions and sources, and enable a detailed, comprehensive analysis of the study subject or phenomena in its natural setting. Case studies can use both qualitative and quantitative analytical methods and is not unique to either (Yin, 2009). As case study methodology allows the gathering and collating of multiple and subjective perspectives, it constitutes a more appropriate strategy than the quantitative

approach to investigate corporate scandals over time as it enables the compilation of a “thick description” and a richer understanding of the phenomenon under study.

While many single case studies have been conducted, the multiple case study design involves separate analyses of several related cases to inductively and analytically derive emerging themes within data sets (in an approach somewhat similar to grounded theory). The common framework applied in cross-case analysis enables the identification of common or recurring themes or patterns among different large-scale corporate governance offenses. This framework is termed the logic model which outlines the repeating cause and effect patterns by synthesizing the four cases following a research design comprising five essential components: research questions, theoretical propositions, units of analysis, logic linking propositions, and criteria for interpreting the results. The remainder of this chapter will outline them and establish how the analysis of this thesis will be structured including the rationale for applying Sherman’s model to comprehend the recurrence of the corporate scandals despite the cycle of corporate reforms.

The corporate scandal cases will be scrutinized in detail in the next chapter to identify and analyse their commonalities. Against the institutional and political framework of corporate governance postulated in this thesis, the common macro-social factors framing the four cases include the political, social, and regulatory/control context. The first addresses the political environment of the organization; the next discusses the social context fostering the scandalous behaviour while the final context converges on the failure of the formal and informal control systems, including the regulatory agencies, in moderating corporate scandals. Similar frameworks have been used to examine such corporate scandals as the Imperial Foods fire, the Exxon-Valdez oil spill

and the space shuttle Challenger explosion (Aulette and Michalowski, 2006; Cruciotti and Matthews, 2006; Kramer, 2006).

## **5.2 Research Questions**

The first component of a case-study design consists of the research questions that address the continued recurrence of corporate scandals in politically-linked companies despite the introduction of corporate governance reforms. These appear as RQ 3a, RQ 3b, and RQ 3c in the overall research questions for this thesis. A brief summary of each of the case study questions are found below.

**Research Question 3a:** Focusing on the evolution of politically-linked corporations in Malaysia, with special reference to a cross-case study of Government-Linked Companies (GLCs), what are the essential dimensions of crony capitalism as they impinge on governance issues?

**Research Question 3b:** What has been the nature of the state's responses to major corporate scandals?

**Research Question 3c:** Have the state's responses been effective in mitigating damage and harm to society and laid stronger institutional foundations to anticipate corporate governance misbehaviour?

**Research Question 3d:** What are the critical institutional weaknesses that are contributing to the ineffective implementation and enforcement of proper corporate governance and its recurrence of corporate scandals?

### **5.3 Theoretical Propositions**

To Yin (2009), explication of the research questions should lead to a specific statement of purpose centred on a theoretical issue shaping the study intent. The purpose of this thesis is to derive insights into the major contextual and institutional factors that influence the recurrence of corporate scandals (particularly of politically-linked corporations) despite the cyclical attempts at corporate governance reform in Malaysia, post-AFC. It proposes that, by conducting a multiple and cross-case study of corporate scandals, a pattern of scandal and reform can be uncovered applying Sherman's (1978) model of police corruption scandals. Sherman (1978) argues that the cyclical pattern of the phenomenon evolves from insufficient understanding of its primary underlying causes grounded on the inherent opportunities for organizational deviance in modern corporate structures, security markets and political systems. This thesis predicts that corporate governance reforms have proven ineffective and led to continued societal distress because of the overarching institutional context of the country's political economy model. The cross-case study methodology confronts these study propositions by identifying common themes and patterns for analysis to derive analytical insights into the recurrence of corporate scandals despite corporate governance reforms.

### **5.4 Unit of Analysis**

Single cases of corporate crimes will constitute the study's analytical unit. A "case" is defined as a corporate scandal arising after corporate governance reforms, post-AFC. A scandal refers to a constellation of corporate governance failings committed by a business enterprise, individuals within it or groups of organizations in a particular industry, causing harm to society.

Specific business scandals often result in significant reform initiatives consistent with Yin's (2009) concept of "embedded" analytical units occurring within the context of the main analytical unit. Governmental reactions and reforms do not occur in isolation or spontaneously and should be examined within the context of the corporate scandals. Thus, the primary analytical unit in this thesis is a specific corporate scandal, while the subsequent state reactions and reforms constitute the embedded units of analysis.

Data on these scandals and reforms should emanate from multiple sources and be synthesized (Yin, 2009). The secondary data supporting this study was retrieved from scholarly literature, newspaper articles, government reports and court decisions linked to the case studies. An extensive search for cogent material was conducted for each case, the relevance of any particular source was subjectively determined by the researcher. The triangulation of multiple data sources generated inferences and interpretations connected to the research questions. While the source data cannot be all-inclusive and is patently outside the researcher's reach, the comprehensive range of documents and records collated constitutes a sufficient body of data to hypothesize the general nature of the four scandals and their embedded common patterns and themes.

The four major cases of corporate and financial aberrations were selected specifically for the ensuing widespread societal harm. All four cases were post-AFC and occurred in Malaysia, allowing for a consistent sample of corporate scandals in different industries unfolding temporally. The four cases selected are the Port Klang Free Zone (PKFZ), Sime Darby Berhad, National Feedlot Corporation (NFCorp), and Tajudin Ramli/Malaysian Airlines System Berhad. They are representative of far-reaching government, political and business linkages (emblematic of the country's political economy model), serious aberrations in good corporate governance and the subsequent

intervention and enforcement by the state. These four cases provide an effective lens to scrutinize corporate scandals and reforms in Malaysia underpinned by a logic model generating commonalities in their behavioural and phenomenological patterns.

### **5.5 Logic Model and Cross-Case Synthesis**

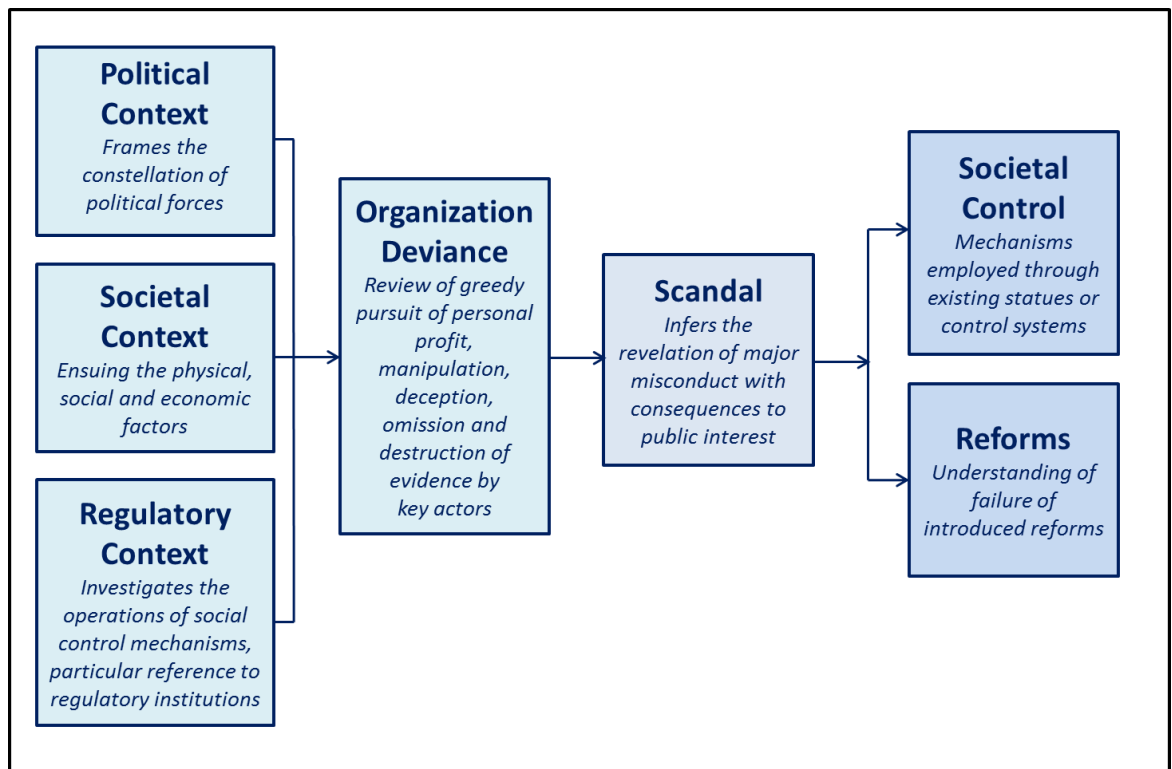
A framework is required to analyse the four corporate cases, embracing organizational governance deviant behaviour, a consequent public scandal and legal prosecution. The framework adopted is Sherman's (1978) model applied to study police corruption in four major American cities to gain insights into the phenomenon and the efficacy of post-scandal reforms to prevent its recurrence. Scandals serve to focus and mobilize public outrage and disgust, subsequently pressuring reformative actions and policies; additionally, they can become social control mechanisms to drive either internal or external changes to eliminate corrupt behaviour. Sherman (1978) also discussed the preventive and punitive controls required, establishing that recurrence appears inevitable unless deep changes in the behaviour of police officers can be effected.

Sherman's (1978) model applied a microanalysis of the individual police organizations and their internal structural reactions. By modifying it to suit a macro-social perspective, his general arguments can be extrapolated to other organizational deviance phenomena. This thesis, thus, will analyse common patterns and themes in corporate scandals and the efficacy of the reforms and prosecutions by the government to prevent its recurrence framed by Sherman's cyclical model.

Figure 5.1 displays Sherman's (1978) model to analyse corporate scandal and reform. The conceptual framework starts with three contexts shaping the scandal: political, societal and regulatory/control contexts which support organizational deviance leading

to a public scandal and the resulting social pressure to initiate corrective and preventive reforms.

Figure 5.1  
Model of Scandal and Reform



Source: Sherman (1978)

Once the scandal develops, the institutions of state, particularly, its executive arm, are mobilized and sanctions enforced through the use of criminal, civil or administrative laws. The four cross-case studies will be compared and synthesised using the adapted Sherman (1978) framework to uncover common patterns of societal reactions to major financial crimes.



## **5.6 Criteria for Interpreting the Results**

Each part of Figure 5.1 will be applied to the four cases using cross-case synthesis to determine the commonalities observed in each facet of the scandal and reform model. Comparisons will be made and the analytical findings summarized to derive the similarities uncovered. Chapter 8 will then discuss the policy alternatives based on these common patterns.

Using multiple cases and replicating the analytical methods for each case will enable the original propositions to be re-shaped to fit any case information deviating from the model (Yin, 2009) and generate stronger relational conclusions. If multiple cases support the analytical model propositions, such replication can justify the research propositions (Yin, 2009) similar to conducting multiple experiments to analytically extrapolate the results to broader theoretical propositions. If contradictions are found in the replications, the propositions must be modified and re-tested with multiple cases. The major rival hypothesis is the lack of clear and consistent inter-case patterns. When conclusions are inferred from the analysis, any alternative propositions should be eliminated or acknowledged as limitations in the original propositions. The analytical results flowing from the application of the study framework can be tested for their generalizability in subsequent corporate scandals (Yin, 2009).

## **5.7 Limitations**

To discover the state's responses to and policy implications arising from the major corporate and financial crimes, a unique case study research design was applied. Its major limitation is the broad conceptual model posited in Figure 5.1 above. In order to provide a wider contextual understanding of corporate governance scandals transcending the firm-level analysis invariably applied, the overarching model of the country's political economy is postulated as the "umbrella" fostering corporate misbehaviour. The intimate political-business nexus is founded on the hegemonic power vested and applied by the dominant and senior political party, UMNO, and its complicit partners in the ruling Barisan Nasional. A weakness in this study, then, is the lack of rigorous propositions links the overarching model of national governance with the diffuse firm-level corporate governance

A second limitation, is the generalizability of the findings of this enquiry into the recurrent nature of corporate scandals in Malaysia to other corporate scandals in the country, region and elsewhere. The cases studies are specifically chosen for their profound societal damage on multiple levels; less extensive cases not leading to governance reforms may not fully fit the model.

Another design limitation is the application of a model, originally developed to analyse police corruption, to corporate governance infractions. There are distinct dissimilarities between these phenomena that may complicate the transferability of the concept. This limitation has been dealt with by adapting the concept to reflect these phenomenological differences and focusing on general patterns instead of attempting an exact replication of Sherman's (1978) study. There being no extant model for studying corporate scandal

and reform, Sherman's (1978) method is a viable framework for examining cyclical corporate governance misbehaviour and the ensuing reforms.

As only four cases of corporate crimes were selected from a larger population, their choice, to some extent, affects their perceived commonalities to enable the generalizability of their findings. The ability of the research propositions to fit the diverse case evidence provides design validity for this thesis (Yin, 2009).

Each of the criticisms regarding the generalizability of the case study findings can be directed to all qualitative research strategies. The case study approach is designed to acquire a large repository of in-depth and contextual data encompassing a specific issue whose general themes and patterns can be extrapolated (Yin, 2009). Case studies can extend the knowledge gained from other methods to discover new ways of conceptualizing and comprehending problems. Furthermore, the case study approach overcomes historical barriers limiting available data on these scandals and enables the discovery of macro level patterns.

## **5.8 Conclusion**

The methodological issues related to this thesis are addressed here. The study uses a multiple case study design to uncover common patterns and themes in the four corporate scandals. A large volume of data will be compiled on each case to enable an in-depth understanding of the multiple and complex factors shaping corporate scandals. This data source will be examined applying an analytical framework encompassing the general features of a cycle of organizational deviance, scandal and governance reform. The goal is to discover patterns among the four cases to shape public policy and prevent future large-scale corporate misbehaviour. Chapter 6 will provide a detailed case

history of each of the four corporate scandals, followed by the application and discussion of the logic model in Chapters 7 and 8.

## CHAPTER 6

### CASE HISTORIES OF SELECTED CORPORATE SCANDALS

#### 6.0 Introduction

Chapter 6, in adopting the qualitative research strategy, provides a detailed narrative and case history of the four selected corporate scandals: Port Klang Free Zone (PKFZ), Sime Darby Berhad, National Feedlot Corporation (NFCorp), and Tajudin Ramli/Malaysian Airlines Systems Berhad (MAS). In each corporate scandal, a review of corporate governance failures and the subsequent reaction by the state will be deliberated, concentrating on this study's key research questions: why have corporate governance reforms initiated by the state post-AFC failed to prevent subsequent business misbehaviour, specifically by politically-connected firms. Chapters 7 and 8 will build on this analysis by examining common patterns and themes among these instances of large-scale corporate crimes.

#### 6.1 Case Study 1: Port Klang Free Zone (PKFZ)

##### 6.1.1 Background

The Port Klang Free Zone (PKFZ) project is a 1,000-acre regional industrial park located in Port Klang, Selangor (see Figure 6.1). The project aimed to develop the seaport into a national multimodal transshipment locale offering facilities for international cargo distribution by advancing various investment incentives to investors including tax exemptions on specific products and services, subsidies, permitting the registration of wholly foreign-owned enterprises, capital and profit repatriation, research and development support, and training and export incentives (Lee and Lee, 2012). The

facility comprises 512 warehouses, 2000 covered parking bays, four office buildings, an exhibition centre and a four-star hotel (*Malaysiakini*, 28 May 2009<sup>21</sup>).

The project was officially mooted in 1997 under the *Seventh Malaysia Plan* (1996 – 2000), after the then Minister of Transport and Malaysian Chinese Association (MCA) President Dr Ling Liong Sik's visit to Jebel Ali Free Zone<sup>22</sup> in Dubai. The MCA is a founding partner and the ethnic Chinese component of the national ruling coalition Barisan Nasional (BN). In 1999, the Malaysian Cabinet under Prime Minister Mahathir Mohammed approved the project and placed it under the purview of the Port Klang Authority (PKA), a statutory body under the Ministry of Transport (MOT).

However, in reality, direct control of the project was exercised by the MCA leadership. The MOT Minister is traditionally reserved for an MCA politician, thus assigning him a lucrative source of state-sanctioned rent allocation to political allies and cronies. As is common in the practice of crony capitalism, the entities complicated in the execution of the project included those controlled by senior politicians and politically-linked individuals. The chairman of PKA's board of directors, for example, has always been reserved for senior MCA politicians such as Dr Ting Chew Peh (2000-2004), Yap Pian Hon (2004-2007) and Chor Chee Heng (2007-2008) (Lee and Lee, 2012). Former PKFZ Managing Director, O.C. Phang (1997-2008) was an ex-civil servant, serving as the Director of the Maritime Division in the MOT during Ling's term as Minister. The

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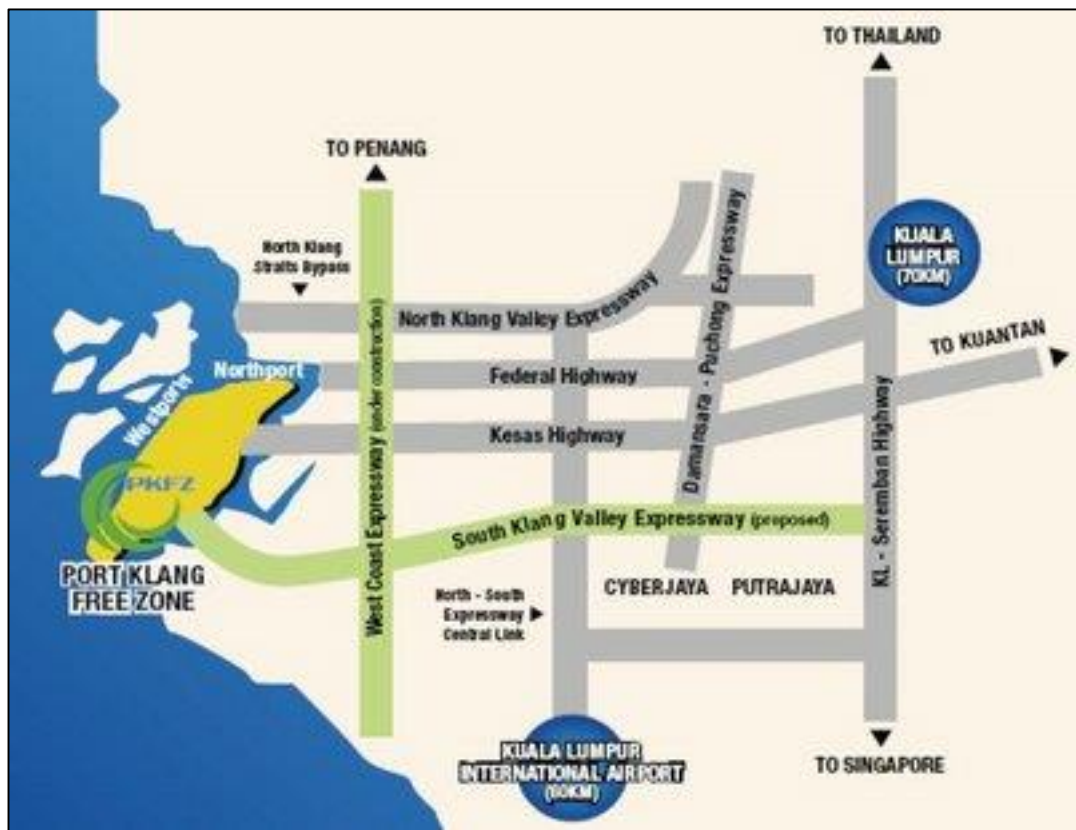
<sup>21</sup> Audit: Kos PKFZ boleh cecah RM12 (18 May 2009). *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com>

<sup>22</sup> Setup in 1985, the Jebel Ali Free Zone covers an area of more than 12,000 acres that attracted over 6,400 occupants employing a workforce of more than 130,000. Jebel Ali Free Zone Authority (JAFZA) operates the Free Zone (Lee and Lee, 2012).

PKA board has also included Abdul Rahman Palil, the representative for Semantah State constituency in Selangor. Abdul Rahman is an influential Selangor UMNO leader.

Figure 6.1

Map of Port Klang Free Zone (PKFZ)



Source: <http://www.pkfz.com>

In 2001, the government, through PKA, appointed Jebel Ali Free Zone International (JAFZI)<sup>23</sup> to manage the project, with a budget totalling RM1.957 billion for land purchase and development works with two agreements:

- (i) an uncompromising pledge by the Minister of Transport that the PKFZ project would not require any public funding given the proposal was feasible and self-financing
- (ii) that every RM100 million deviation in project cost would necessitate a prior Cabinet authorization (Lee and Lee, 2012).

Such conditions indicate that the government had expectations of adequate checks and balances to ensure project sustainability; this did not prove to be the case.

In 2001, PKA appointed a private entity, Kuala Dimensi Sendirian Berhad (KDSB), as the project's turnkey developer with a RM1 billion development contract with the sole right to design, construct and finance the project (Lee and Lee, 2012). KDSB is central to corruption in this project indicating the workings of crony capitalism as the company is closely linked to several senior UMNO and MCA officials during Prime Minister Abdullah Ahmad Badawi's administration. KDSB is a fully-owned subsidiary of Wijaya Baru Holdings Sendirian Berhad (WBHSB) owned by Tiong King Sing, an influential Sarawak businessman turned politician<sup>24</sup>. Tiong acquired control of Wijaya Baru Global Holdings from a former timber tycoon Ting Pek Khiing through a 22 per cent stake. Tiong later resigned from KDSB, WBHSB and a listed company Wijaya Baru Global Berhad (WBGB) in 2010. Tiong owns a 70 per cent stake in KDSB and

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<sup>23</sup> JAFZI is the international consultancy arm of JAFZA. Following its appointment, JAFZI produced the PKFZ Master Plan and Market Assessments Study in 2004.

<sup>24</sup> Tiong was first with the Sarawak National Party (SNAP) and later with the Sarawak's People Democratic Party (SPDP).

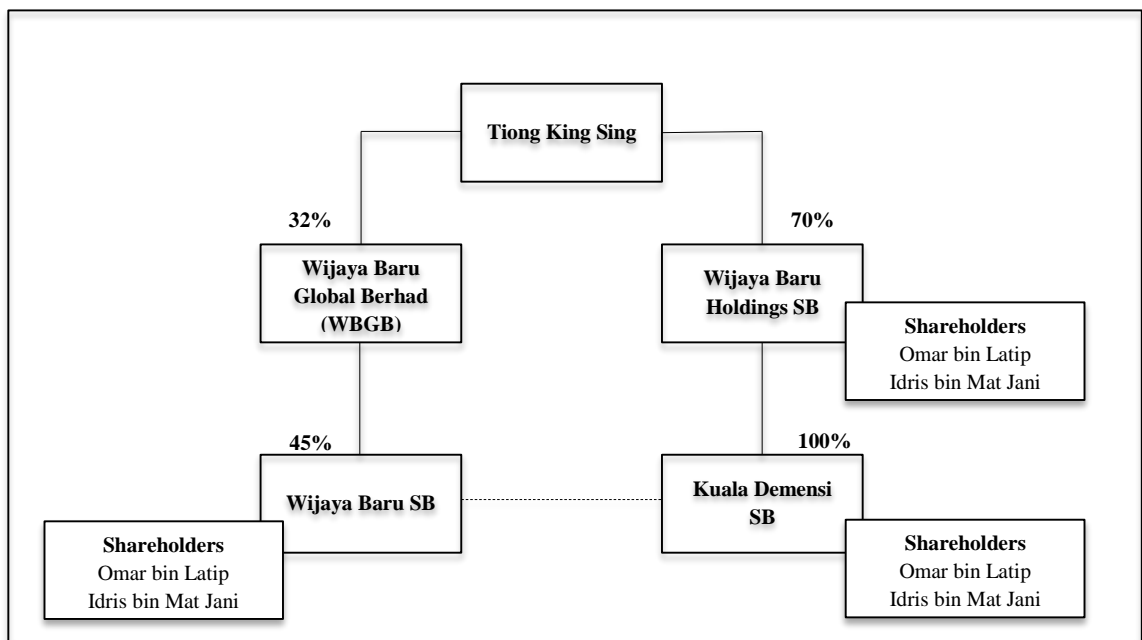


sold his stake in WBGB in 2011. Other owners included Omar Latip and Idris Mat Jani.

Figure 6.2 highlights the ownership structure of the related corporations.

Figure 6.2

Tiong's ownership of Wijaya Baru



Tiong is key actor in the PKFZ scandal, seemingly profiting the most from this project. He is the current Member of Parliament for Bintulu, Sarawak (from 1999), and the former Barisan Nasional (BN) Parliamentary Backbencher's Chief (2008-2013). After the 2013 General Election, Tiong was appointed the South East Asian Trade Envoy by Prime Minister Najib Razak carrying with it ministerial privileges and perks. He is also intimate to former Chief Minister of Sarawak, Abdul Taib Mahmud. Notably, unlike the other politicians involved in this scandal, Tiong was a successful businessman prior to his involvement in politics. Utilizing his wealth, Tiong was able to develop close access to senior politicians in Peninsular Malaysia, in particular those in UMNO and MCA<sup>25</sup>,

<sup>25</sup> In 2006, MCA sold majority ownership of Nanyang Press (M) Berhad to Ezywood Options Sendirian Berhad, a company owned by Tiong's family (i.e. Tiong Hiew King) (*The Sun Daily*,

which resulted in his capacity to be involved in and secure lucrative contracts in the PKFZ project.

Another prominent politician linked to the KDSB is former UMNO party treasurer, Azim Zabidi<sup>26</sup> (2004-2009), who became KDSB director and Chairman in 2003 and is known to be loyal to Abdullah Badawi. Furthermore, from 2007 to 2007, former Deputy Finance Minister, Chor Chee Heung was non-executive Deputy Chairman of Wijaya Baru Global Berhad (WBGB) (WBGB is the parent company of KDSB) and Chairman of PKA (2007–2008) (see Figure 6.2).

The appointment of KDSB's directors raises serious questions about transparency and fairness as the contract was awarded without an open tender and nine months prior to the finalization of the project master plan. KDSB generated handsome profits from the various business dealings linked to the project and selected the key project vendors such as the independent quantity surveyors (QS4 Consortium) and legal advisors, Rashid Asari & Company. QS4 was originally KDSB's quantity surveyor for the infrastructure work (*Malaysiakini*, 9 August 2007<sup>27</sup>). In a letter dated 3 November 2003, PKA's general manager O.C. Phang recommended Syarikat Perunding BE Sendirian Berhad (one of the companies from QS4 Consortium) to the Ministry of Finance (MOF). When it was rejected, Phang, through a letter dated 7 April 2004, pressured MOT Minister Chan Kong Choy to influence MOF Minister Abdullah Ahmad Badawi to appoint Syarikat Perunding BE. In her letter Phang composed:

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18 October 2006). The sale provided the Tiong family a monopoly of Chinese newspapers (i.e., *Nanyang Siang Pau*, *China Press*, *Sin Chew Daily* and *Guang Ming Daily*).

<sup>26</sup> In 2001, Azim was stripped of his UMNO division chief and supreme council posts due to breach of code of ethics during the 2000 party elections.

<sup>27</sup> Abdul Aziz, F. (9 August 2007). Bloods run deep in troubled RM4.6b PKFZ. *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com>

*“We respectfully request your help in appealing to the Finance Minister so that Syarikat Perunding BE is appointed as independent quantity surveyors for the development project on Pulau Indah. To facilitate the proper action, a copy of a draft letter to the Finance Minister is herewith attached.”* (Lee and Lee, 2012:34).

This letter included a copy of the letter drafted by her which was to be sent to Finance Minister (and Prime Minister) Abdullah, minus Chan’s signature (*Malaysiakini*, 9 August 2007<sup>28</sup>).

Such bureaucratic actions clearly show a blatant disregard for the MOF regulations on transparent accounting practices while the counsel of the Attorney-General’s Chambers was not pursued. PKA’s lack of oversight on KDSB is central to the breakdown of governance and led to the unravelling of the PKFZ scandal.

Other influential Selangor UMNO politicians were exposed as having benefited from their links with KDSB and its associate companies. The UMNO officials involved included Onn Ismail, Faizal Abdullah, Abdul Rahman Palil and Abdul Rashad Asari who held various positions in the project’s development as shown in Table 6.1. Such an involvement further reflects on the network of associates linked to crony capitalism in corporate Malaysia.

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<sup>28</sup> Abdul Aziz, F. (9 August 2007). Bloods run deep in troubled RM4.6b PKFZ. *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com>

Table 6.1

## Other Key Actors in the PKFZ Project and Conflicts-of-Interest

No:	Name	Remarks
1	Abdul Rahman Palil	Selangor State Assemblyman for Sementah, Selangor (1999–2008) and Kapar UMNO’s division head. He was Selangor executive councillor. In 2002, he served as both chairman of the Koperasi Pembangunan Pulau Lumut Berhad (KPPL) <sup>29</sup> and as a PKA director during the sale of project land
2	Onn Ismail	KPPL Chairman (until 1996) and a veteran UMNO politician. Onn was Speaker of the Selangor State assembly from 1995 until 2008. He is Kapar UMNO’s permanent chairman.
3	Faizal Abdullah	The Deputy Chief Executive Officer of WBGB. Faizal Abdullah is the son-in-law of Onn and UMNO division’s Youth Chief for the Kapar, Selangor.
4	Rashid Asari & Co	The legal firm engaged by PKA and drafted and oversaw the sales and purchase agreement between KPPL and KDSB in 2004. Senior partner, Abdul Rashid Asari, was UMNO Kapar division deputy chief
5	QS4 Consortium (a consortium consisting of 4 quantity surveyors: 1. Perunding BE Sdn Bhd; 2. Jurukur Bahan H&A; 3. ASA-CM Jurukar Bahan Sdn Bhd; and 4. RK Partnership	Independent quantity surveyor appointed by PKA to monitor the development of PKFZ, as well as to be the final arbiter between PKA and KDSB in the event of disputes over development “cost variations”. This despite being a panel quantity surveyor for KDSB. Phang had pressured MOT to ensure the company’s appointment. By protocol, an independent quantity surveyor (IQS) was to have been appointed by the MOF.

<sup>29</sup> KPPL is the original landowners of the PKFZ project site. KPPL, an UMNO-linked fisherman’s cooperative, was awarded the 1000 acres of land by the Selangor government for farming purposes in 1991. In 1995, 500 acres of this plot of land was sold by KPPL to KDSB for RM31 million. KPPLB eventually sold all the land to KDSB for a total of RM96 million (Lee and Lee, 2012).

### 6.1.2 Scandal Breaks

In early 2006, JAFZI raised concerns about the project to Ling's successor as MOT Minister, Chan Kong Choy (2003-2008). These concerns included political meddling and cumbersome bureaucracy as detailed in the company's 2006 letter to MOT Minister Chan. In this letter, JAFZI officials had stated that "*transparency was non-existent and the Malaysian political and economic landscape has too many vested interests seeking involvement and control in this project*" (*The Sun Daily*, 14 August 2007<sup>30</sup>).

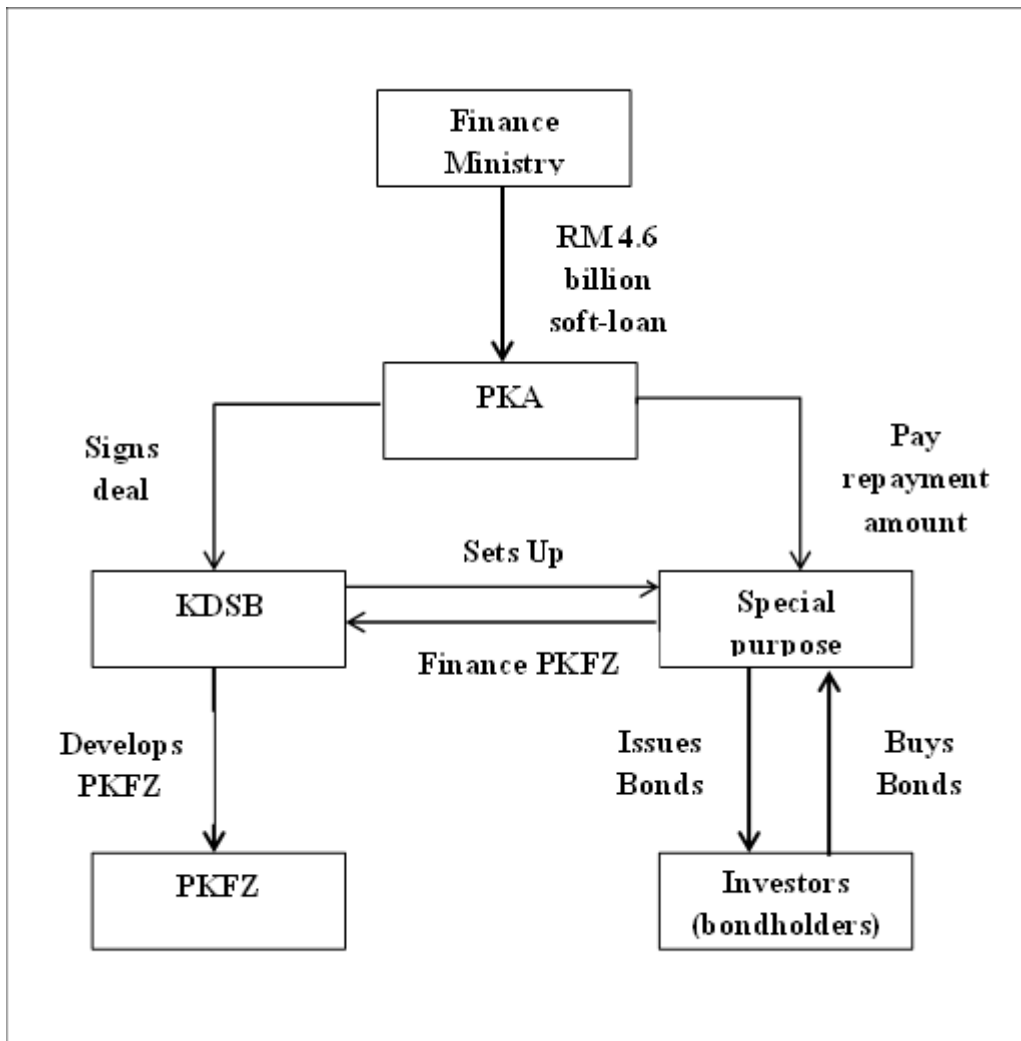
In July 2007, JAFZI decided to pull out from their 15-year contract, citing that their action was for "strategic purposes". However, *The Sun Daily*, quoting various internal emails and documents, reported that the separation was acrimonious and due to, among other factors, interference in the project by political actors and others with vested interests, falsification of meetings minutes and tax evasion by Malaysian mediators (*The Sun Daily*, 14 August 2007). The JAFZI pull-out and their criticisms highlight the severe repercussions of poor corporate governance on the confidence of foreign investors because of political interference in major projects. This interference involved, in particular, the incorporation of companies to participate in the project despite little or no involvement in the PKFZ development. Such external influence on project implementation, underscores the failure of the PKA governance structure to safeguard the project and provide proper implementation oversight. No attempt was made by these politicians to learn how to manage and develop large-scale projects as they were primarily interested in opportunities arising from project-related including land deals and sub-contracts (see Figure 6.3). JAFZI has since collaborated with other Asian ports, i.e., Busan port in South Korea and Subic Bay in the Philippines, to develop projects in the region.

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<sup>30</sup> Disaster Zone (14 August 2007). *The Sun Daily*. Retrieved from <http://www.thesundaily.my/>.

Figure 6.3

PKFZ Transaction Structure



Source: *Malaysiakini*, 29 Jun 2010

In 2008, the annual Audit General Report noted that the initial project cost of RM1.845 billion had ballooned to RM4.947 billion, or RM3.5 billion in overruns (see Table 6.2.). This disclosure would eventually expose the convoluted workings of crony capitalism in the PKFZ project.

Table 6.2

## Schedule of PKFZ payment to KDSB

Year	RM Million
2007	510
2008	660
2009	660
2010	722
2011	487
2012	733
2013	170
2014	170
2015	170
2016	170
2017	179
Total	4,632

Source: PwC Report (2009)

In spite of these cost overruns, PKFZ only enjoyed an occupancy rate of less than 20 per cent, about 50 per cent of which was for light industrial units, 5 per cent for office blocks, about 25 per cent of the land was occupied by a hotel and exhibition hall which were not operational (*Malaysiakini*, 12 Jun 2007<sup>31</sup>). Following the expose, there was an eruption of public outrage over the abuse and wastage of public funds, compounded by accusations of fraud and exploitation of power by senior politicians from the MCA, UMNO and Sarawak, involving the role of businessman-politician Tiong. There have

<sup>31</sup> Poser over mega 'ghost town' (12 June 2007). *Malaysiakini.com*. Retrieved from <http://malaysiakini.com/>.

been a number of allegations that Tiong utilized his wealth to bribe the then MCA President Ong Tee Keat and then MCA Youth Chief Wee Kia Siong (*The Malaysian Insider*, 29 August 2009<sup>32</sup>). Both MCA leaders have denied these allegations.

Initially, the MOT blamed the project's cost overruns on JAFZI mismanagement, arguing that the PKFZ's initial plan was to develop it in two phases, each covering 500 acres costing RM400 million. However, JAFZI had insisted that the project be developed in a single phase, ultimately costing RM1.845 billion (*Biz New Dubai*, 23 August 2007<sup>33</sup>). This was patently untrue as PKA had decided on the single phase development model.

### **6.1.3 PriceWaterhouseCoopers (PwC) Audit Report**

In the wake of the public outcry over the scandal and perceived government inaction, the then MOT Minister, Ong Tee Keat, instructed PriceWaterhouseCoopers (PwC) to conduct an audit into the reported financial irregularities in 2008. After a number of delays, the report was finally published in 2009 underlining 20 key areas of concern, categorized into five broad areas:

- Agreement preconditions
- Financial consequences
- Project management
- Financial commitments
- Financial standing

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<sup>32</sup> Cash Delivered in hotel carpark, Tiong claims in police report (29 August 2009). *The Malaysian Insider*. Retrieved from <http://themalaysianinsider.com/>.

<sup>33</sup> Malaysian Government to assist Port Authority stuck with \$1B debt (23 August 2007). *Biz New Dubai*. Retrieved from <http://www.english.biznewsdb.com/>.



The PwC Audit Report (2009) indicated that, firstly, no appropriate studies were done prior to initiating the project, thereby pinning the blame on the MOT. There was virtually no proper government project management and control despite it being a multi-billion project. PKA's management was incompetent and lacked business acumen: the then Managing Director, O.C. Phang, testified during a Public Accounts Committee (PAC) session that she was ignorant of what a financial plan entailed (*Malaysiakini*, 2 September 2009<sup>34</sup>). This despite her shipping industry experience and being the first woman and Malaysian to be the President of the International Associations of Port and Harbours and the first Chairman of the Tokyo MOU, the Asia-Pacific's intergovernmental organization for ship inspections. It would be fair to infer that her alleged incompetence was used to cover the greed and corruption rampant in the project.

The PwC Report (2009) asserted "a general lack of Board oversight and governance over the project" while major project decisions were made without prior PKA board approval and without MOT and MOF counsel. Such actions imply covert influence and interventions bypassing the board, the managing director and the higher authorities. It could be argued that the PKA board directors may have been aware of the irregularities but had little power to prevent them given their subservience to powerful politicians.

The PwC Report (2009) also noted that project cost escalations, poor governance by PKA and weak project management had undermined the project's viability. It concluded that there was inadequate governance and enforcement of checks and balances; one glaring example cited was that when KDSB failed to deliver the monsoon drain, water

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<sup>34</sup> PAC blames Phang's weak management (2 September 2009). *Malaysiakini.com*. Retrieved from <http://malaysiakini.com/>.

supply system and two bridges (as specified in the land purchase agreement), the project did not deduct the relevant infrastructural costs.

#### **6.1.4 Purchase of Land**

The 1,000 acres of Pulau Indah land intended for the project was initially owned by UMNO through the Koperasi Pembangunan Pulau Lumut Bhd (KPPLB), a fisherman's cooperative which, in 1991, had been awarded the land by the Selangor government for farming purposes (Lee and Lee, 2012). KPPLB eventually sold all the land to KDSB for RM96 million, or around RM3 per square foot.

Prior to KDSB's land sale to the PKA, the Valuation and Property Services Department in the Ministry of Finance (MOF) was instructed to value the land for PKFZ for direct purchase and compulsory acquisition which it did four times between 1998 and 2001 (Lee and Lee, 2012). In February 2001, the Cabinet was informed that the land was valued at RM25 per square foot or a total of RM1.088 billion. In June 2001, PKA was advised by the MOF to initiate the procurement under the Land Acquisition Act 1960 although valuing it between RM10.16 to RM13.50 per square foot (Lee and Lee, 2012). The Selangor State Government objected, arguing it did not qualify for "public purpose" under Section 3(1) of the Land Acquisition Act 1960, indicating political manoeuvring as it wanted the sale to be done at a commercial price, not at a discounted cost.

In November 2002, after intense lobbying by PKA's management, Cabinet's approval was given to proceed with the land purchase. PKA purchased the land on a commercial value for RM1.088 billion, or approximately RM25 per square foot at a net gain to KDSB of nearly RM700 million (Lee and Lee, 2012). This sale and the decision to

service the land purchase agreement through deferred payment terms reflect questionable and unethical conduct by KDSB and poor oversight by PKA. Interestingly, this agreement led KDSB to overcharge PKA of up to RM300 million in interest and hidden costs of RM100 million. In aggregate, the land price escalated to the equivalent of RM41.50 per square foot.

### **6.1.5 Letters of Guarantee**

Another glaring dimension of the PKFZ scandal is the serious allegation that two senior Cabinet ministers falsified government documents to support the project. During their tenure as MOT Minister, Dr Ling (1986-2003) and Chan (2003-2008) issued four Letters of Guarantee for KDSB to raise RM4 billion bonds for the project (Lee and Lee, 2012). The first Letter of Support dated 28 May 2003 was Ling's last day as Transport Minister. Chan issued three support letters in 2003, 2005 and 2006 (Lee and Lee, 2012). Both Ministers had breached MOF regulations, as the MOT Minister has no authority to produce financial guarantees on the state's behalf; the lone authority lays with MOF Minister has this authority, after Cabinet approval.

With these Letters of Support, the project bonds were rated an investment grade AAA, guaranteeing that the PKA would fulfil its commitments on timely manner. The project costs could potentially amount to RM12.45 billion, if the port defaults and the government pays interest on its debt (PwC, 2009). A leaked Cabinet document notes that *"(t)he government needs to carry the financial burden of RM4,632,732,000 in the form of soft loan to PKA... the government's contingent liability will increase to RM4,632,732,000 if PKA cannot repay the bonds which have been issued. This amount does not include Medium term Notes at RM85mil and RM75mil respectively which are*

*yet to be issued"* (Cabinet Memorandum, 22 June 2007:5). The actions of both Ministers indicate the abuse of power.

Furthermore, the PKA Managing Director has been implicated in issuing a letter of undertaking to OSK Securities Berhad stating that the government would use budget allocations for a special reserve account for the PKA; this was done without prior approval of the Transport or Finance Ministries (PwC, 2009). Civil charges have been filed against Phang; see Table 6.3 for all allegations of wrongdoing by Phang.

Table 6.3

Allegation of wrong doings by OC Phang

<b>No.</b>	<b>Alleged Wrongdoings</b>
1	Failure to consider PKA's self-financing ability to the purchase of the land. Entering into expensive development contracts with KDSB totalling RM1.055 billion
2	Failure to consider the land's special value of RM25 per square foot had included an additional interest of 7.5 per cent
3	Failure to be mindful of the official advice to appoint quantity surveyors for the Development Agreement, Additional Development Work 1 and New Addition Development Works. Delay in the appointment of the quantity surveyors and therefore limiting their role.
4	Insistence that Perunding BE Sdn Bhd be appointed as the sole quantity surveyor with the knowledge that the firms had a conflict-of-interest with KDSB for the PKFZ project
5	Making unilateral resolutions without the approval of the PKA board

Source: Lee and Lee (2012)

In 2009, PKA chairperson Lee Hwa Beng<sup>35</sup> (March 2008 to March 2011) lodged a police report against KDSB over possible fraudulent claims of between RM500 million and RM1 billion and a RM920 million lawsuit against KDSB and other related parties. Despite these civil suits, the government released RM3.039 billion to service the KDSB project bonds. After Lee stepped down as chairman in 2011, PKA has withdrawn its complaint to the Bar Council against Rashid Asari & Co in the conflict-of-interest involved in preparing the sale and purchase agreements on behalf of PKA for the PKFZ project (*The Malaysian Insider*, 16 April 2012<sup>36</sup>). These actions indicate that political interference may have played a part in ensuring that certain actors are provided political security against legal prosecution.

#### **6.1.6 Cost Overruns**

By 31 December 2008, the project cost had escalated to RM4.947 billion, an overrun of RM3.5 billion, exceeding the development combined costs of both Pelabuhan Tanjung Pelepas (PTP) and West Port, the two other major ports in Malaysia, almost wiping out PKA's corporate reserves of RM500 million (PwC, 2009).

To rescue the project, the government approved a RM4.632 billion soft loan to bail out the project as PKA was unable to service the first scheduled payment in 2007 to KDSB. The soft loan attracted a 4 per cent yearly interest rate over 20 years questioning the government's financial prudence and discipline as it plunged the project into further debt; the additional RM2.506 billion interest burden pushed the total project to

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<sup>35</sup> Lee Hwa Beng was PKA chairman from March 2008 to March 2011. An MCA member, Lee served three terms as Selangor state assemblyman for Subang Jaya. Lee was later replaced as PKA Chairman by Teh Kim Po. Teh was appointed by new MOT Minister, Kong Cho Ha, who had replaced Ong Tee Keat.

<sup>36</sup> PKA denies dropping lawsuits against KDSB (16 April 2012). *The Malaysian Insider*. Retrieved from the <http://themalaysianinsider.com>

RM7.453 billion. The PwC Report (2009) anticipates that PKA would not be able to service the debt obligations, which would need restructuring adding RM5 billion interest costs, translating to an aggregate PKFZ project of RM12.453 billion. Based on its own (optimistic) assumptions, PKA would suffer a cumulative cash flow deficit for the next 42 years, until 2041 (see Table 6.4)

Table 6.4

Cumulative Financial Position for PKFZ

(RM billion)	2001	2008	2017	2036	2051
Land	1.088	1.088	1.088	1.088	1.088
Development	0.869	2.34	2.34	2.34	2.34
Interest to KDSB			1.425	1.425	1.425
Interest to MOF				2.506	5.0
Total	1.957	3.522	4.947	7.453	12.453

Source: PwC Report (2009)

### 6.1.7 Regulatory Action

In July 2007, the Cabinet was briefed about the developing financial scandal and poor governance and decided to set up a special taskforce to investigate the project, headed by Mohd Sidek Hassan, then Chief Secretary to the Government (*Bernama*, 7 October 2009<sup>37</sup>). Mohd Sidek was tasked to identify criminal acts related to PKFZ, recommend action against the guilty parties, ways to improve governance and management and prepare a restructuring plan and business models for PKA and PKFZ.

<sup>37</sup> PKFZ Super Task Force Members named (7 October 2009). *Bernama*. Retrieved from <http://www.bernama.com/>.

The government and the Public Accounts Committee (PAC) have been taken to task for their inaction; the latter, charged with examining the accounts of the government, State governments, statutory bodies and public authorities, lamely argued that they did not have the “jurisdiction” to investigate this case and could only advise the enforcement authorities like the police and the MACC to pursue the matter (*The Malaysian Insider*, 31 July 2010<sup>38</sup>).

With the PwC report (2009) and the subsequent public outcry, the government initiated a joint investigation by the police and MACC into the PKFZ project including the project land acquisition price, financial records of payment claims and other related issues. Subsequently, six individuals were charged in court, including two former MOT Ministers, Ling and Chan, both accused of lying to the Cabinet by unlawfully issuing four Letters of Support to KDSB. Ling was also charged with irregularities in the project land valuations and failure to disclose the interest imposed on 404.4ha of Pulau Indah land purchase in leading to KDSB being paid RM1.808 billion, involving an overpayment of RM720 million. Ling was also charged on two alternative charges of deceiving the Cabinet about the 7.5 per cent further interest rate per year on the land price inducing it to approve the land purchase and causing losses; and that the Valuation and Property Services Department had approved the land valuation although no such approval had been given. Four PKFZ management staff have been charged with offenses summarized in Table 6.5.

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<sup>38</sup> Pakatan defends PAC’s probe into Ling’s role in PKFZ (31 July 2010). *The Malaysian Insider*. Retrieved from [http://www.themalaysianinsider .com/](http://www.themalaysianinsider.com/).

Table 6.5

## Charges brought against Management Staff related to the Project

Name	Position	Charges
OC Phang	Former PKA General Manager	Three charges for criminal breach of trust totalling RM 254.8 million
Bernard Tan	Consultant architect for KDSB	24 charges of making false claims amounting RM122.3 million
Law Jenn Dong	Former Project Manager for PKFZ	24 charges of making false claims amounting RM116.8 million
Stephen Abok	Chief operating officer of KDSB	Two charges of making false claims amounting RM5.4 million

In October 2013, the Kuala Lumpur High Court acquitted Ling of all charges of cheating the government in relation to the PKFZ land deal as Judge Ahmad Asnawi found reasonable doubt in the prosecution's case and placed the blame on MOT officers who prepared the documents (*The Malaysian Insider*, 25 October 2013<sup>39</sup>). His acquittal, despite the strong evidence, reflects adversely on the Attorney General's Chambers' capacity to execute a competent prosecution of a high profile case (*The Malaysian Insider*, 10 November 2013<sup>40</sup>). The Attorney General's Chambers was criticized for not recording a statement from the key material witness, the then Prime Minister Mahathir, who testified for the defense that as Prime Minister and Cabinet head at the material time, he did not feel cheated. The defense had also called on Fong Chan Onn (former Minister of Human Resources) and Abdul Kadir Sheikh Fadzir (former Minister of Tourism) who supported Mahathir's statement that Ling did not deceive the Cabinet (*The Malaysian Insider*, 25 October 2013<sup>41</sup>). Following the acquittal, the Attorney

<sup>39</sup> Ex-ministers Dr. Ling acquitted of cheating Putrajaya in PKFZ land deal (25 October 2013). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>40</sup> Khairy say AG must explain why no appeal filed in Ling's cheating case (10 November 2013). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>41</sup> Ex-ministers Dr. Ling acquitted of cheating Putrajaya in PKFZ land deal (25 October 2013). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.



General's Chambers decided not to appeal the verdict citing the slim possibility of winning the case. While the charges against Ling suggests that enforcement against governance misdeeds are taken seriously, his acquittal raises questions whether any state institution in Malaysia can objectively pressure for accountability when dealing with a hegemonic UMNO.

#### **6.1.8 Introduction of Whistle Blowing Act 2010 (WBA)**

As part of the broader Government Transformation Programme (GTP) and responding to the PKFZ scandal, the government introduced the Whistle Blowing Act 2010 (WBA) to protect individuals who report corrupt and unethical activities. MOT personnel were assigned to PKA to receive complaints from all parties while an online link was available on the PKA website to report mismanagement, corruption, conflicts-of-interest, abuse of power, procurement irregularities and sexual harassment. No action would be taken against unfounded reports but deliberate false reports would be punished.

Under the WBA, a whistleblower is only entitled for protection if a report is to government enforcement agency exclusively. Even if this occurs, protection can be revoked if the report “principally involves questioning the merits of government policy, including policy of a public body, or if the whistleblower commits an offence under the WBA, such as disclosing the contents of his report to a third party. It is an offence punishable by a fine of up to RM50,000 and imprisonment of up to 10 years if a whistleblower or the person receiving or investigating the report discloses any information about the person accused of wrongdoing, or any other information disclosed by the whistleblower, to a third party” (Laws of Malaysia, 2010).

Any whistleblower in Malaysia disclosing information deemed to be an official secret can be imprisoned under the Official Secrets Act 1972 for a minimum of one year and a maximum of seven years. In 2013 a new section 203A (1) and (2) was added to the Penal Code targeting civil servants releasing information to the public without permission, risking a fine of up to RM1 million and a jail term of up to a year, or both. Under this amended law, anyone, including the media, receiving such information shall suffer the same fate. The provision can be perceived to prevent the disclosure of information that may expose corruption and fiscal mismanagement and portrays the deep-seated institutional aversion to initiate tangible action to eliminate crony capitalism.

## 6.2 Case Study 2: Sime Darby Berhad Scandal

### 6.2.1 Background

Sime Darby Berhad is a leading Malaysian public-listed government-linked company (GLC) conglomerate involved in six core sectors: plantations, property, industrial, motors, energy and utilities (E&U) and healthcare. The government controls Sime Darby through the Perbadanan Nasional Berhad (PNB) and Employee's Provident Fund (EPF). In January 2007, Sime Darby entered into a US\$11 billion merger with Guthrie Berhad and Golden Hope Plantation Berhad to become a leading global listed oil palm plantation group, supplying about 8 per cent of the world's palm oil output (simedarby.com).

In 2010, Sime Darby's corporate governance and investment practices were questioned after it posted its biggest ever loss of RM2 billion (*The Malaysian Insider*, 5 August 2010<sup>42</sup>). In October 2009, cost overruns were exposed by the board of directors, aiming to established to "assess the corporate governance and performance" of its E&U division (*The Malaysian Insider*, 5 August 2010). In 2008, Sime Darby's net profit was RM726 million but it announced anticipatable losses of RM2.1 billion for its E&U division. The large portion of the losses were attributed to ill-advised investments in Qatar's energy and utilities sector and poor business practices in the Bakun Dam development in Sarawak. Table 6.6 provides details of the project losses (*The Malaysian Insider*, 5 August 2010).

Given its core plantation business, these losses raise queries about its reserves in the oil and gas and energy industries and the efficacy of its internal governance mechanisms

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<sup>42</sup> Sime Darby to report biggest ever loss (5 August 2010). *The Malaysian Insider*. Retrieved form <http://www.themalaysianinsider.com/>.

and practices in checking dubious investments. Its previous major loss occurred post-AFC, when its financial arm, Sime Bank Berhad, posted a RM1.6 billion loss. The lost was the largest in Malaysian banking history —the corporation recorded a net financial year loss of RM540.9 million in 1998 (*The Malaysian Insider*, 5 August, 2010)

Table 6.6  
Summary of Sime Darby Berhad Losses for Second Half  
of Financial Year 2010

<b>Project</b>	<b>Details</b>
Qatar Petroleum project	Losses amounting to RM526 million due to delays and cost overruns
Maersk Oil Qatar project	RM367 million has already been documented in the first half FY2010 and the board has decided to recognize the remaining RM159 million.
Maersk Oil Qatar	The board estimates losses of about RM155 million due to construction of vessels.
Bakun Hydroelectric Dam project	Management estimates potential additional cost of RM450 million

Source: *The Star*, 13 May 2010

In May 2009, Sime Darby’s Board of Directors (BOD), led by former Deputy Prime Minister Musa Hitam, engaged forensic consultants and independent legal advisors to determine evidence of culpability. In May 2010, the external consultants reported irregularities in four key energy projects; the Bulhanine and Maydan Mahzam project with Qatar Petroleum, Maersk Oil Qatar project, Bakun hydroelectric dam project and the “Marine Project” (*The Malaysian Insider*, 20 September 2010<sup>43</sup>). The BOD decided to lodge reports with the relevant authorities and to initiate legal measures (*The Malaysian Insider*, 20 September 2010). Sime Darby’s then acting chief executive, Datuk Mohd Bakke Salleh, declined to publicly disclose the forensic report citing legal advice as it was instituting a civil suit (*The Malaysian Insider*, 20 September 2010).

<sup>43</sup> Audit shows misconduct in Sime Darby energy unit (20 September 2010). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

### 6.2.2 Bakun Dam

Situated on the Balui River in Sarawak, the Bakun project is a 700sq km embankment dam able to produce 2,400 megawatts of electricity to reduce Malaysia's reliance on oil and gas for electricity. It was initially planned that approximately 90 per cent of output was to be channelled to Peninsular Malaysia through undersea cables, however this plan has since been scrapped (*Reuters*, 15 April 2011<sup>44</sup>).

The dam's reservoir covers 23,000 hectares of virgin rainforest and is a human and ecological disaster dislocating over 10,000 indigenous people (*Reuters*, 15 April 2011). The project was termed one of the world's "Monuments of Corruption" (Transparency International, 2005), with years of delays, ownership changes, doubling of overall costs and output capacity exceeding future power needs. The Bakun project symbolizes the monopolization of benefits for politically-connected individuals and their cronies enriched by lucrative contracts. Sarawak's chief minister, Abdul Taib Mahmud and his family have encountered numerous corruption allegations involving this project. Speculation has it that the Bakun project was initiated to enable the Chief Minister to harvest the construction site for timber (*Reuters*, 15 April 2011). Taib and his family have also been connected to proprietorship of multi-billion dollar assets in the United States, Australia, Canada, United Kingdom and Malaysia (*Reuters*, 15 April 2011). A recent documentary video by a London-based non-government organization (NGO), Global Witness, has connected Taib to corruption and money laundering (*Free Malaysia Today*, 20 March 2013<sup>45</sup>).

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<sup>44</sup> Koswanage, N. and Fong, M.H. (15 April 2011). FACTBOX - Malaysia's Bakun dam: White elephant or growth engine? *Reuters*. Retrieved from <http://www.reuters.com/>.

<sup>45</sup> They want to frame me, say Taib (20 March 2013). *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com/>.

Mooted during Prime Minister Mahathir's administration, the Bakun hydroelectric power plant project was first proposed in 1980 but abandoned during an economic recession in the mid-1980s. It was revived and approved in 1993 but faced numerous delays and setbacks. The project was first awarded to a private joint-venture Bakun Hydroelectric Corporation, comprising Ekran Berhad, Tenaga Nasional Berhad (TNB), the Sarawak Government, Sarawak Electricity Supply Corporation (Sesco) and Malaysia Mining Corporation Berhad (MMC). With the exception of Ekran, all the other companies involved in this project are controlled by the federal government or the Sarawak State government. However, the project was abandoned following the 1997 AFC with the government compensating Ekran RM1.1 billion (*Reuters*, 15 April 2011). Ekran was then controlled by Ting Pek Khing, a timber tycoon closely associated with Taib though he had also impressed Mahathir with his capacity to expedite the construction of major projects (*Reuters*, 15 April 2011<sup>46</sup>).

Its third revival began in May 2000 using a 100 per cent government-owned company, Sarawak Hidro, set up by the Finance Ministry. This company, in turn, awarded a turnkey contract to the Malaysia-China Hydro JV, led by Sime Engineering Sendirian Berhad of Malaysia (a subsidiary of Sime Darby) and Sinohydro Corporation of China with a RM18 billion budget and completion date of September 2007. Sime Engineering Sdn Berhad was the lead company while the main Chinese partner was China Water Resources and Hydro Power Engineering Corporation (*Reuters*, 15 April 2011). Civil work started on October 2002; other consortium members are WCT Berhad, MTD Capital Berhad, Ahmad Zaki Resources Berhad, Syarikat Ismail and Edward & Sons Sendirian Berhad, all of which also have political connections.

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<sup>46</sup> Koswanage, N. and Fong, M.H. (15 April 2011). FACTBOX - Malaysia's Bakun dam: White elephant or growth engine? *Reuters*. Retrieved from <http://www.reuters.com/>.

Although slated for completion in 2007, the project officially began operations only in August 2011 (*Reuters*, 15 April 2011). While initially appraised at RM7.46 billion, the Bakun project then saw chief promoter, State-owned Sarawak Hidro unable to resolve financial claims by contractors amounting to RM 820 million (*The Malaysian Insider*, 7 May 2012<sup>47</sup>). A joint-venture company, Malaysia-SinoHydro Company Joint-Venture (MCHJV) had put in claims amounting to RM670 million for civil works. Argentinian contractors supplying turbines, IMPSA group, had also put claims amounting to RM140 million (*The Edge*, 7 May 2010). These came during a period when Sarawak Hidro was frantically searching for potential buyer to acquire the electricity produced. In order to resolve and settle the RM700 million claims issue, the Malaysian government awarded Sime Darby ownership of the Bakun hydroelectric power plant. Sime Darby's involvement, due to the funding issue, shows that the government intended to utilize its abundance of cash reserves to finance those involved in the project.

In March 2012, Rio Tinto and Cahaya (leading global miner) and Mata Sarawak (CMS) Berhad, a conglomerate owned by Taib's family, dismissed plans for a US\$2 billion (RM6.1 billion) aluminium smelter project in Sarawak (*Malaysiakini*, 26 April 2012<sup>48</sup>). The Sarawak government has since proposed to build another 12 hydroelectric dams, the next being the Baram Dam. The announcement that these dams would be built drew further attention to the failure of the Bakun project. Crucially too, the employment of Sime Darby to acquire an interest in the flawed Bakun project surfaced how publicly-

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<sup>47</sup> RM820m claims to drive up Bakun Dam cost (7 May 2012). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>48</sup> Bakun Dam left with no reason to exist (26 April 2012). *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com/>.

listed GLCs were being abused. It also suggested that the Sime Darby board of directors had little autonomy to determine whether to participate in the project. This, however, was merely the beginning of a controversy that would escalate as Sime Darby's corporate strategies began to unfold.

### **6.2.3 "New Concept" Land Deals**

To develop Sarawak, the Government approved a joint-venture (JV) between Sime Darby Plantation Sendirian Berhad and Sarawak's Land Custody and Development Authority (PELITA), a statutory body under the Sarawak government. This JV fell under Taib's "New Concept" Sarawak Upstream Expansion Plan Land policy on native customary rights (NCR) land. This project enabled a private investor (in this case Sime Darby) to hold a 60 per cent stake in each JV, Pelita 10 per cent on the State government's behalf, and the balance in trust for the NCR landowners. This model allows major private investors to have access to NCR land, usually for 60 years, without compensating the native communities. This "New Concept" has effectively "robbed the needy to feed the greedy". Hundreds of native communities have initiated state-wide legal action against the government claiming the end of their traditional communal land rights (Cramb, 2007). The government has been repeatedly berated by the courts for failing to obtain prior and informed consent from all landowners involved before launching JVs as many village heads have been induced to sign the JV agreements on behalf of entire communities, without consulting other villagers. NCR landowners claim that the Federal Constitution, Sarawak's Land Code and a corpus of Malaysian legal precedents guarantee their native rights (*FreeMalaysiaToday*, 8 December 2011<sup>49</sup>).

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<sup>49</sup> Tawie, J. (8 December 2011). Cheated natives to sue Taib. *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com/>.



However, Sime Darby was not awarded the aforementioned land in 2008 and 2009 by the government which was given to Nature Ambience Sendirian Berhad and Vertical Drive Sendirian Berhad. 99.9 per cent equity of each company was effectively owned by a local businessman, Chew Chiaw Ann, CEO of a construction company called Metro Sedia Sendirian Berhad (Cramb, 2013). In the past two years, Chew's companies have received several multi-million-ringgit government contracts. This includes; one RM6 million contract to supply solar power to rural Long Peluan comprising about 400 people at a staggering cost of more than RM15,000 per resident (Cramb, 2013).

In June 2011, Ting Tze Fui, the State Assemblyman for Meradong Sarikei, revealed a letter dated 20 November 2008, signed by the Ministry for Land Development granting approval to Vertical Drive (registered in October 2008) to develop 48,199 hectares of NCR land (*FreeMalaysiaToday*, 23 May 2013<sup>50</sup>). In October 2009, the Ministry for Land Development awarded Nature Ambience (registered in October 2008) 26,211 hectares of land to develop. To initiate the project, Sime Darby paid RM16.8 million to buy Nature Ambience and RM85 million for Vertical Drive from Chew Chiaw Ann (*FreeMalaysiaToday*, 23 May 2013).

Ting, in exposing these self-enriching land deals, stated that “Sime Darby is not the only investor to have been ripped off by the web of (state) BN politicians' and cronies' companies” (*FreeMalaysiaToday*, 23 May 2013). Other corporations such as Tabung Haji Plantations have also falling prey to such corrupt practices damaging the confidence of potential investors in land development and other projects in Sarawak while exposing the abuse of NCR land (*FreeMalaysiaToday*, 23 May 2013). Through

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<sup>50</sup> Tawie, J. (23 May 2013). Sensitive issues barred in S'wak assembly. *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com/>.

the "New Concept" *modus operandi* in Sarawak, provisional land leases were opaquely granted for plantation JVs involving well-connected local companies which were later sold to plantation investors at a premium.

#### **6.2.4 Sime Darby's E&O deal**

Apart from the above corporate misbehaviour, Sime Darby was also implicated in improper dealings involving its E&O property group, where the group possessed 30 per cent ownership. This ignited insider trading accusations against the Securities Commission's (SC) as the RM776 million as the deal involved the husband of the SC chairman, Zarinah Anwar. Zarinahs' husband was the E&O chairman and had raised his personal stake in the company prior to Sime Darby's proposed investment. The SC is now being sued by a minority shareholder for not compelling Sime Darby to announce a general offer for all E&O shareholders (*The Malaysian Insider*, 23 December 2011<sup>51</sup>). Such actions hint at possible impropriety and influence by GLCs and well-connected individuals.

#### **6.2.5 Actions Taken**

The Public Accounts Committee (PAC) initially declared that it would question Sime Darby about the RM2.1 billion losses but later backtracked ostensibly because it lacked jurisdiction as this GLC (a subsidiary of PNB and whose primary stakeholder is the EPF) is legally a privately owned business (*FreeMalaysiaToday*, 23 November 2010<sup>52</sup>).

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<sup>51</sup> Minority shareholder sues SC over Sime's E&O offer waiver (23 December 2011). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>52</sup> PAC sings a different tune: Sime Darby not our problem' (23 November 2010). *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalysiatoday.com>

In May 2010, Sime Darby's BOD requested Ahmad Zubir Murshid, its president and group chief executive, to take a leave of absence prior to the expiry of his contract on 26 November 2010 (*The Wall Street Journal*, 13 May 2010<sup>53</sup>) citing RM964 million cost overruns in the Qatar projects and the Bakun Dam and the purchase of Sarawak New Concept land in Kapit, Julau and Sarikei. Sime Darby later appointed a close associate of Prime Minister Najib Razak, Bakke Salleh as acting chief executive (*The Malaysian Insider*, 19 June 2010<sup>54</sup>).

In July 2012, Ahmad Zubir, was indicted with two counts of criminal breach of trust (CBT) and cheating involving Sime Darby's acquisition of NCR land in Sarawak and allegedly failing to prevent two companies from acquiring land earmarked for Sime Darby's use under the Sarawak Upstream Expansion Plan despite having acquired government JV approval. The first charge carries a jail term of not less than two years and not more than 20 years, whipping and a fine, while the second carries a maximum jail sentence of seven years, a fine or both. Ahmad Zubir has since pleaded not guilty to both charges (*The Star*, 17 July 2012<sup>55</sup>). In both cases, the MACC and the Attorney General's Chambers have not targeted Chew who is speculated to be Taib's proxy. The MACC has faced international condemnation for failing to report any progress on its probe on allegations of corruption against Taib (*The Edge*, 16 July 2013<sup>56</sup>).

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<sup>53</sup> Sime Darby CEO Asked to Leave Amid Losses (13 May 2010). *The Wall Street Journal*. Retrieved from <http://online.wsj.com>

<sup>54</sup> Boo, S.L. (19 June 2010). Najib defends Bakke's appointment at Sime Darby. *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>55</sup> Former Sime Darby CEO Ahmad Zubair charged with CBT (17 July 2012). *The Star Online*. Retrieved from <http://www.thestar.com.my/>.

<sup>56</sup> Shanmugam, M. (16 July 2012). Highlight: Will MACC's probe on Taib see daylight? *The Edge*. Retrieved from <http://www.theedgemaalaysia.com>

In December 2010, Sime Darby and its three subsidiaries (Sime Engineering Sendirian Berhad, Sime Darby Holdings Berhad and Sime Darby Energy Sendirian Berhad) filed two civil suits against Ahmad Zubir and four others (*The Edge*, 24 December 2010<sup>57</sup>). This first is for RM338 million in Qatar Petroleum, Maersk Oil Qatar and marine projects while the second is for a RM 90.5 million restitution, relating to the Bakun Dam project. Ahmad Zubir has filed a counter-suit against the Board, claiming that he executed what the latter had approved. However, the Board insists that it had been “misled and kept away from true information” (*The Star*, 17 December 2010<sup>58</sup>).

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<sup>57</sup> Sime Darby files civil suit (24 December 2010). *The Edge*. Retrieved from <http://www.theedgemaalaysia.com/>.

<sup>58</sup> Former Sime Darby CEO Ahmad Zubair charged with CBT (17 July 2012). *The Star Online*. Retrieved from <http://www.thestar.com.my/>.

### 6.3 Case Study 3: National Feedlot Centre (NFC) Scandal

#### 6.3.1 Background

In 2006, the MOF under the *9th Malaysia Plan* allocated RM74 million for the National Feedlot Centre (NFC) project. This project, under the jurisdiction of the Ministry of Agriculture and Agro-based Industry (MOA), aimed to boost national beef production, specifically to increase *halal* beef output by 40 per cent and to reduce beef imports by 2010. An 809-hectare cattle rearing site in Gemas, Negeri Sembilan was provided by the Negeri Sembilan State government. NFC was assigned the following objectives:

- Set up an Entrepreneur Development Programme to train 130 satellite farmers
- Build a livestock feed factory
- Build a biogas factory to process waste into fuel for the farm (*The Malaysian Insider*, 25 October 2011<sup>59</sup>)

In October 2007, the federal government awarded a 30-year contract to the National Feedlot Corporation (NFCorp) to manage the project through a special trust account. NFCorp is owned by Agrosience Industries Sendirian Berhad, in turn owned by Mohamad Salleh Ismail, husband of UMNO Wanita Chief and then Minister of Women and Family Affairs, Shahrizat Abdul Jalil. Salleh is the NFC's Executive Chairman, with his three children serve as Chief Executive Officer (Wan Shahinur Izran), executive director (Wan Shahinur Izmir Salleh) and director (Wan Izzanah Fatimah); all had no previous experience in managing a livestock corporation, but were paid substantial salaries (*The Sun Daily*, 23 February 2012<sup>60</sup>).

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<sup>59</sup> Audit finds minister's family made mess of national cattle farming project (25 October 2011). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>60</sup> Nadeswaran, R. (23 February 2012). NFCorp directors in the dark. *The Sun Daily*. Retrieved from <http://www.thesundaily.my/>.

The NFCorp Board also included representatives from the MOA, Finance Ministry and Negeri Sembilan State government to “safeguard the interest of the federal government and stakeholders and the State government as it provided the land” (*The Sun Daily*, 23 February 2012). They were each paid directors’ and meeting allowances of RM700 monthly (*The Sun Daily*, 23 February 2012). The Finance Ministry holds a “golden share” in NFCorp (*The Sun Daily*, 23 February 2012).

Management problems exposed in the 2010 Auditor General’s Report indicated that NFCorp had attained only 41.1 per cent of the target 8000 breeding cattle by 2010 and under 10 per cent of the projected slaughtering. The media reported the Auditor General’s Report claim that the RM250 million NFC project was a “mess”, highlighting that between 2007 and 2010, RM48.71 million of the RM74 million allocation had been spent (*The Malaysia Insider*, 25 October 2011<sup>61</sup>). In this “cowgate” scandal, the potential criminal offences relate to the award of the project (in its family and political connections) and its questionable execution.

### **6.3.2 Misuse of Company Funds**

In December 2007, a soft loan of RM250 million was awarded to NFCorp through a special trust account to initiate the feedlot project by establishing and financing NFC (*The Malaysian Insider*, 25 October 2011). The project contract required NFC to submit progress reports certified by a technical committee comprising representatives from the MOA, Veterinary Department, University Putra Malaysia (UPM) and University Kebangsaan Malaysia (UKM) (*The Malaysian Insider*, 25 October 2011<sup>62</sup>). However,

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<sup>61</sup> Audit finds minister’s family made mess of national cattle farming project (25 October 2011). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>62</sup> Audit finds minister’s family made mess of national cattle farming project (25 October 2011). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

despite failing to meet project targets since its launch and the technical committee certification, the Auditor-General's Report showed that NFC continued to draw down the loan. Also, the MOF ignored its own requirement that the NFC provide monthly bank statements of the special loan account detailing loan expenditures (*The Malaysian Insider*, 25 October 2011).

Opposition party leaders have publicly exposed the misuse of project funds alleging that NFCorp's annual losses included over RM27 million for property purchases and such unrelated expenses as over RM800,000 for overseas travel and entertainment (*The Star*, 11 March 2012<sup>63</sup>).

The opposition party, Parti Keadilan Rakyat (PKR), further revealed that NFC had purchased a land in Putrajaya worth RM 3.3 million, a Mercedes Benz CLS 350 CGI worth RM534, 622 and a luxury Marina Bay suites in Singapore worth RM34.6 million, all of which were registered under the names of Salleh and his son and NFCorp executive director Wan Shahinur Izran Salleh (*The Star*, 11 March 2012). Also, NFCorp subsidiary, Farmhouse Supermarkets Pte Ltd, had leased commercial space worth RM2.2 million a month in order to launch a supermarket in Rochester Mall, Singapore. Salleh later argued the rental of commercial space in Singapore was because the local market could not support the company's beef production (*The Star*, 11 March 2012). NFCorp had also leveraged the RM250 million soft loan to obtain loans for eight shop lots in KL Eco City in Jalan Bangsar, Kuala Lumpur with a forced-sale RM9.69 million value (*The Star*, 11 March 2012). Allegations were made that NFCorp

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<sup>63</sup> Chronology of NFCorp issue (11 March 2012). *The Star Online*. Retrieved from <http://www.thestar.com.my/>.

purchased a RM1.7 million office apartment in Almaty, Kazakhstan (*The Star*, 11 March 2012).

All purchases were done without NFCorp's BOD approval, the three government representatives claiming that they were not consulted or informed of these acquisitions, although it is a statutory requirement that board approval by resolution be given for any "investment"; the board members were also not updated on the fund drawdown from the RM250 million soft loan (*The Sun Daily*, 23 February 2012<sup>64</sup>). PKR leaders have lodged reports about mismanagement of public funds and abuse of power to the police and the MACC against Sharizat, Salleh, Prime Minister Najib Razak, Deputy Prime Minister Muhyiddin Yassin and Agriculture Minister Noh Omar (*The Star*, 11 March 2013<sup>65</sup>).

Salleh has refuted allegations of mismanagement stating that the project is only in its third year of a 30-year contract and that it had missed targets due to teething problems while adding that the NFCorp had exceeded targets for breeding cattle (*The Star*, 11 March 2013). The property purchases were apparently part of the company's long-term investment strategy; the Bangsar condominiums earned RM70, 000 rentals monthly (although the current market rate is only RM24, 000). NFCorp also denied the procurement of the KL Eco City property stating it was a "private investment" (*The Star*, 11 March 2012). The property investments were better than relying on money market instruments while Wan Shahinur asserted that the Singapore condominium units

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<sup>64</sup> Nadeswaran, R. (23 February 2012). NFCorp directors in the dark. *The Sun Daily*. Retrieved from <http://www.thesundaily.my/>.

<sup>65</sup> Chronology of NFCorp issue (2012, March 11). *The Star Online*. Retrieved from <http://www.thestar.com.my/>.



were bought as the government had halted construction of an export quality abattoir for rent to NFCorp (*The Star*, 11 March 2013).

### **6.3.3 Political Scandal**

The NFCorp scandal generated considerable negative publicity for the government and UMNO prior to the 2013 General Election, with a public focus on Salleh's wife, UMNO women wing Chief, Shahrizat, who claimed innocence of the NFCorp business dealings as it was only coincidental that she was the NFC Chairman's wife (*The Sun Daily*, 6 December 2013). PKR Strategic Director Rafizi Ramlil said that Shahrizat would be "guilty by association" if she was aware of public fund mismanagement and did not alert the authorities. Declaring that she and the Wanita UMNO were being discredited, Shahrizat filed RM100 million defamation suits against Rafizi and PKR Women Wing Chief Zuraida Kamaruddin. Rafizi has responded with a counter-claim (*The Malaysian Insider*, 26 June 2013<sup>66</sup>).

After the initial scandal and its ramifications broke, Deputy Prime Minister and Deputy UMNO President Muhyiddin Yassin, UMNO Youth Head Khairy Jamaluddin and Selangor UMNO Head Noh Omar (MOA minister when the scandal broke) publicly supported Shahrizat. Muhyiddin, who was MOA Minister when the NFCorp contract was awarded, initially stated that police and the MACC investigations were unnecessary as he was certain all investments were done in good faith (*The Malaysian Insider*, 30 November 2011<sup>67</sup>).

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<sup>66</sup> NFCorp sues Rafizi and Malaysiakini (26 June 2013). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>67</sup> Kamal, S.M. (20 November 2011). UMNO Youth told to 'defend' Shahrizat in NFC scandal. *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

This provoked even more intense public rancour against the BN government and calls for Shahrizat to resign her government and party posts, even by a wide range of UMNO leaders and BN component party leaders (including former Prime Minister Dr Mahathir Mohammed and former UMNO Wanita head Rafidah Aziz) as it would affect UMNO's performance in the 13th General Election (*The Malaysian Insider*, 28 March 2012<sup>68</sup>). In April 2013, Shahrizat's appointment as a senator ended – a person can serve on this capacity for a maximum two terms - and so did her Ministerial position; this was lauded as a sacrifice by senior leaders. Nevertheless, Shahrizat has gone on to successfully defend her Wanita UMNO chief position indicating that the corruption fallout had not been taken seriously within the party, an idea reinforced by her appointment as the Prime Minister's special advisor on Women and Family Matters with full ministerial privileges (*The Star Online*, 19 August 2013<sup>69</sup>).

#### **6.3.4 Response by Authorities**

Following police reports against the NFCorp, the MACC and police initiated an investigation. In December 2011, then Deputy Inspector-General of Police, stated that there were no discrepancies or mismanagement had been found while UMNO Vice President and then Home Minister Hishammuddin Hussein claimed, at the 2011 UMNO General assembly, that no criminal breach of trust (CBT) was evident reaffirming top UMNO support for Shahrizat (*The Star*, 3 December 2011).

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<sup>68</sup> Rafidah 'worries' about Wanita Umno (28 March 2012). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>69</sup> Bedi. R., (19 August 2013). Shahrizat back as special adviser to Najib. *The Star Online*. Retrieved from <http://www.thestar.com.my/>.

Shahrizat later took three weeks leave from her ministerial duties (from 13 January to 5 February 2011) to facilitate investigations and allow the authorities to complete their investigations; their report was submitted to the Attorney General's Chambers at the end of 2012 but was returned for further investigations in January 2013 (*The Malaysian Insider*, 2 March 2012<sup>70</sup>). The police have since recommended that the Attorney General indict NFCorp directors with CBT (*FreeMalaysiaToday*, 25 February 2012<sup>71</sup>).

The police questioned Salleh about possible CBT and raided NFCorp, recording 74 individuals' statements and freezing its assets. A report was given to the Attorney General's Chambers which twice requested further investigations, widely interpreted as a delaying tactic to postpone any further action until after the 13th General Election.

The Public Accounts Committee (PAC) also investigated how the RM250 million soft-loans were disbursed in 2008, prior to the official agreement being signed in 2009. After meeting with MOA representatives, PAC chairman Azmi Khalid admonished the government for recurring weaknesses in the management of public funds and subsequently met with then Chief Secretary to the Government and Finance Ministry officials in January 2012. The PAC meeting with NFCorp represented by its human resource general manager lasted only 30 minutes as the company's lawyers advised against answering any questions as it would be *sub judice* because of court hearings on the scandal (*FreeMalaysiaToday*, 20 March 2012<sup>72</sup>). The PAC confirmed that NFCorp has defaulted on repayments for its government loan since January 2012 (the first

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<sup>70</sup> AG send back NFCorp investigation paper to police (2 March 2012). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

<sup>71</sup> Cops want charges against NFCorp directors (25 February 2012). *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com>

<sup>72</sup> Palani, T. (20 March 2012). NFCorp cites sub judice, remains silent at PAC hearing. *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com>

instalment of RM17 million being due January 2012) and as at 31 July 2011, RM181.9 million had been drawn down. The PAC later stated that as there was no personal guarantee involved, no individual can be held accountable (*The Malaysian Insider*, 20 January 2012). In January 2012, Deputy Prime Minister Muhyiddin Yassin announced that the government would engage an audit company to scrutinize the project (*The Star Online*, 19 January 2012<sup>73</sup>). In March 2012, the MOA Minister, Noh Omar, indicated that the government intended to tender the project out to interested parties (*The Star*, 25 March 2012<sup>74</sup>).

Salleh was charged on 12 March 2012 with two CBT counts under Section 409 of the Penal Code for RM49.7 million and two counts of violating the Companies Act 1965 in not seeking company annual general meeting approval to use the money for direct profit. Salleh claimed trial to all four charges and was granted bail of RM500,000 with one surety (*The Malaysian Insider*, 13 March 2012<sup>75</sup>).

The police have also arrested Shamsulbahrin Ismail, CEO of Shamsulbahrin Ismail Resources Sendirian Berhad who allegedly tried to bribe investigating officers over the NFC issue with RM1.7 million. Shamsulbahrin was also accused of deceiving Salleh for false consultation worth over RM1.755 million. Shamsulbahrin has since lodged a police report asserting that an NFCorp official had “pressured me to bribe police to

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<sup>73</sup> DPM: We’ll appoint accounting firm to look into use of loan fund (19 January 2012). *The Star Online*. Retrieved from <http://www.thestar.com.my/>.

<sup>74</sup> Tenders to be called to take over NFC: Noh Omar (17 March 2012). *The Star Online*. Retrieved from <http://www.thestar.com.my/>.

<sup>75</sup> Kamal, S.M. (2012, March 13). Shahrizat’s hubby charged with CBT in NFC scandal. *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

close the NFC case” (*FreeMalaysiaToday*, 29 June 2012<sup>76</sup>). Shamsulbahrin faces up to 10 years in prison and caning and fine upon conviction of the offences.

#### **6.4. Case Study 4: Malaysian Airlines Systems (MAS) /Tajudin Ramli Scandal**

##### **6.4.1 Background**

In July 1994, the government, through a privatization exercise, sold 32 per cent of Malaysia’s national carrier, Malaysian Airlines System Berhad (MAS) to Tajudin Ramli, through his company Naluri Berhad<sup>77</sup> and he was appointed Chairman and Managing Director (*The Asian Sentinel*, 24 August 2010<sup>78</sup>). That same year, Tajudin bought Malaysia’s sole cellular operator, Celcom Berhad; giving him control over two monopolies (*The Asian Sentinel*, 24 August 2010). An ex-merchant banker and closely linked to the former Finance Minister, Daim Zainuddin, he was a shining exemplar of the new Bumiputra corporate captains who were being carefully nurtured by Prime Minister Mahathir Mohammed to run major domestic conglomerates and who could compete with ethnic Chinese businessmen (*The Asian Sentinel*, 24 August 2010).

Tajudin obtained a personal loan of RM1.79 billion in July 1994 from local banks to purchase MAS shares at RM8.00 each although it was trading at RM3.30 (*The Asian Sentinel*, 24 August 2010). When he took control of MAS in 1994, it had cash reserves exceeding RM600 million (*The Asian Sentinel*, 24 August 2010). However, between 1994 and 1998, Tajudin failed to service the loan, thus making it a non-performing loan

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<sup>76</sup> Vinod, G. (29 June 2012). Whistleblower charged to protect the guilty. *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com/>.

<sup>77</sup> Tajudin's company, Technology Resources Industries Berhad, bought Naluri, then known as Malaysian Helicopter Services Berhad, from MAS in 1991.

<sup>78</sup> Malaysian Saga of Corruption Ignored (24 August 2010). *Asian Sentinel*. Retrieved from <http://www.asiasentinel.com/>

(NPL), inducing Danaharta to acquire the loan. By 2001, MAS had accumulated losses exceeding RM8 billion (*The Asian Sentinel*, 24 August 2010).

Following the AFC, the government bailed out MAS through a RM1.8 billion buyback from Naluri at RM8 per share when it was trading at RM3.68 per share (*The Asian Sentinel*, 24 August 2010). In March 2001, Finance Minister Daim rationalized the bailout to save national pride and prevent a foreign takeover (*Utusan Malaysia*, 21 Mac 2001<sup>79</sup>), while Prime Minister Mahathir assured the public that any misappropriation and mismanagement would be punished (*New Strait Times*, 24 July 2001<sup>80</sup>).

As at October 2001, Tajudin had defaulted on his debt of RM1.41 billion and failed to service it; in April 2002, Danaharta demanded RM1.61 billion from Tajudin. Taking over Tajudin's parent company, Naluri, gave Danaharta control of about RM900 million ringgit balance of the RM1.8 billion ringgit buyback. Subsequently, Danaharta sold parts of the charged shares in Tajudin's Technology Resources Industries (TRI) Berhad at RM2.75 each, netting RM717.39 million. As part of a settlement arrangements, Tajudin was to repay RM942 million in four payments over three years and was allowed to redeem his charged shares at a minimum price per share. As at 31 December 2005, the sum unsettled was RM589.14 million and on 11 May 2006, Danaharta and the subsidiaries initiated legal action to recuperate the money.

In the ensuing legal wrangling, Tajudin filed a RM13.46 billion countersuit alleging that his acquisition was a involuntary "national service", masked as business agreement, to

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<sup>79</sup> Beli Saham MAS pertahankan maruah Negara- Daim (21 March 2001). *Utusan Malaysia*. Retrieved from <http://www.utusan.com.my/>.

<sup>80</sup> UEM takeover includes debts (24 July 2001). *New StraitsTimes*. Retrieved from <http://www.nst.com.my/>

appease the investment community and public (*FreeMalaysiaToday*, 27 February 2012<sup>81</sup>). He also claimed that it was the Mahathir and Daim who ordered him in 1994 to purchase a controlling stake in MAS and he acted as the former's proxy in a ploy to apply the "profit" from the share sale to cover Bank Negara's forex losses due to Daim's currency speculation when the ringgit's value plummeted in the AFC (*FreeMalaysiaToday*, 27 February 2012). Also, both politicians had reassured him he would not suffer any losses or liability from the MAS share purchase (*FreeMalaysiaToday*, 27 February 2012).

#### **6.4.2 Corporate Governance Failures**

Under Tajudin, many corporate governance failures became apparent as he made major decisions without reference to the MAS board and with companies in which he or his family had personal interests. One such company was the Advanced Cargo Logistics (ACL) whose directors included Rizana Mohd Daud, Tajudin's sister-in-law, his brother, Bistamam Ramli, and companies owned by Tajudin or his family.

ACL was formed by Tajudin by allegedly colluding with three MAS officers and directors through two nominee companies (in Singapore and Hong Kong). ACL was located in Hahn Airport in Frankfurt, Germany which was selected to offer ground-handling services for MAS. Tajudin had relocated MAS cargo operations in Europe from Amsterdam and Frankfurt to Hahn through ACL although as it was not equipped to deal with large aircraft. Outgoing cargo was transported on smaller aircraft and then by land to Frankfurt for customs clearance, resulting in monthly losses of between

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<sup>81</sup> Tajudin deal connected to 1992 forex losses? (27 February 2012). *FreeMalaysiaToday.com*. Retrieved from <http://www.freemalaysiatoday.com/>.

RM10 million to 16 million (*The Asian Sentinel*, 5 March 2012<sup>82</sup>). By November 2000, MAS had suffered RM174 million losses and, to avoid bankruptcy, the MAS board shelved the Hahn project, only to have ACL sue it for RM300 million for breach of the 10 year contract.

In 1998, Tajudin sold MAS aircraft to MAS Capital, another company under his control which leased the planes back to MAS. Although their total book value was RM9.5 billion, depreciation of the ringgit raised its actual value to RM14 billion, which MAS Capital refinanced and used the surplus to pay Tajudin a combination of cash and shares valued at RM739 million for his stake in two of his companies to clear his personal debts (Satkunasingam and Cherk , 2012). When investors raised objections, Mahathir stated publicly that this was a normal process (Pereira, 1998). Tajudin is also alleged by MAS to have deceitfully concealed his stakes in Cendanasari Insurance Brokers Sendirian Berhad, relating to land in Langkawi and a luxury yacht, *Colombo Star* (Satkunasingam and Cherk, 2012). Tajudin responded that these allegations by MAS were malicious and in bad faith, to embarrass him and tarnish his reputation (Satkunasingam and Cherk, 2012).

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<sup>82</sup> Mahathir's Disastrous Financial Speculation (5 March 2012). *Asian Sentinel*. Retrieved from <http://www.asiasentinel.com/>



### 6.4.3 Actions Taken

In May 2005, the MAS board made a police report alleging that Tajudin had entered into many fraudulent contracts and unprofitable business activities causing MAS to lose more than RM8 billion (*Malaysiakini*, 22 February 2012<sup>83</sup>). However, no action was taken by the police (*Malaysiakini*, 22 February 2012).

In March 2007, Ramli Yusuff, Director, Commercial Crime Investigation Department (CCID) reported to Prime Minister Abdullah Ahmad Badawi that "when Tajudin left MAS in 2001, MAS had accumulated losses in excess of RM8 billion (US\$2.54 billion). Many projects were made under very suspicious circumstances" (*The Asian Sentinel*, 5 March 2012). In a 2007 letter to Abdullah, Ramli Yusuff indorsed a series of charges against Tajudin, Wan Aishah Wan Hamzah, the former MAS director, and others for not affirming their interest in ACL. According to Ramli Yusuff:

"Since ACL is controlled by Tajudin's family companies, it is therefore presumed...that he has used his office and position as Executive Chairman of MAS to benefit ACL when MAS entered into (the agreements). This offence is punishable with mandatory imprisonment (up to) 20 years and a fine not less than five times the sum of gratification. CCID's investigation has disclosed that there is sufficient evidence to prosecute Tajudin, Wan Aishah and (another official) for all of the above offenses." (*The Asian Sentinel*, 5 March 2012<sup>84</sup>).

Abdullah, however, did not pursue the matter which was speculated to be due to his involvement in a 2002 business deal involving his brother Fahim Ibrahim who had

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<sup>83</sup> MAS Scandal: The gov't must let the truth be told (22 February 2012). *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com/>

<sup>84</sup> Mahathir's Disastrous Financial Speculation (5 March 2012). *Asian Sentinel*. Retrieved from <http://www.asiasentinel.com/>

purchased MAS Catering Sendirian Berhad from Tajudin (Abdullah was then Deputy Prime Minister) (*The Asian Sentinel*, 5 March 2012). Abdullah had allegedly instructed Tajudin to give his brother's company an option to buy 51 per cent of MAS Catering, which was later sold to Lufthansa's LSG Skychef at a huge profit as disclosed in a court case involving Advent Management Sendirian Berhad suing Fahim's firm for renegeing on commission fees (*Malaysiakini*, 12 August, 2003<sup>85</sup>). Instead of initiating charges against Tajudin, the Police and MACC investigated Ramli for non declaration of assets as imposed under law and abuse of governmental resources and power (*Bernama*, 18 March 2010<sup>86</sup>). Presiding over the trial, Judge Supang Lian expressed that the "evidence was not credible and not to be believed." (*The Asian Sentinel*, 24 August 2010). Ramli ultimately had to endure 3 rounds of appeals before finally being acquitted in 2011 (*The Sun Daily*, 25 November 2011).

In May 2009, MAS lodged a report to the MACC alleging Tajudin of fraudulent practices and a conspiracy between the police and the Attorney General's Chambers to protect Tajudin from charges. In the report, MAS highlighted that when Tajudin seized control of MAS in 1994, the company had RM600 million cash reserves but when he left, it had accumulated losses of RM8 billion (*The Asian Sentinel*, 24 August 2010<sup>87</sup>). The MACC report also refers to two previous police reports made on 4 January 2002 and 4 May 2004 (*The Asian Sentinel*, 24 August 2010<sup>88</sup>). The Government responded by

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<sup>85</sup> Pak Lah told to clarify brothers MAS deal (12 August 2003). *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com>.

<sup>86</sup> MACC's Appeal against Sessions Court's Decision on Ramli Yusoff Dismissed (18 March 2010). *Bernama*. Retrieved from <http://www.bernama.com/>.

<sup>87</sup> Malaysian Saga of Corruption Ignored (24 August 2010). *Asian Sentinel*. Retrieved from <http://www.asiasentinel.com/>

<sup>88</sup> Malaysian Saga of Corruption Ignored (24 August 2010). *Asian Sentinel*. Retrieved from <http://www.asiasentinel.com/>

announcing that based on MACC's investigations, Tajudin was found to have breached Section 131 of the Companies Act 1965, which involves disclosure of interest (*The Asian Sentinel*, 24 August 2010). Tajudin's lawyers responded by claiming that Tajudin had only been an UMNO proxy and claimed that UMNO "not only has to protect him from prosecution but that they also had to ensure that the government bought back the shares at the same price that they were sold to him although the shares were only worth a portion of the real value" (*The Asian Sentinel*, 13 October 2010<sup>89</sup>).

#### **6.4.4 Out-of-Court Settlement**

In August 2011, the government instructed Danaharta and all other GLCs to cease the civil action against Tajudin as it wished to pursue an out-of-court settlement (Ng, 2011). Putrajaya sought to strike out Tajudin's counterclaim alleging that the government and MAS defamed him to cover-up details in Tajudin's affidavit that Dr Mahathir had forced him to buy MAS in 1994 to help bail out Bank Negara with an "Overriding Agreement" to indemnify him against any losses suffered. Dr Mahathir denied this in his March 2012 autobiography and stated that Daim Zainuddin was responsible for putting together this deal involving Tajudin (Mahathir, 2012).

In February 2012, an out-of-court settlement between Tajudin and Danaharta and several other GLCs was agreed on, writing-off the RM580 million judgement debts and all other pending suits. In June 2012, MAS and Tajudin agreed to surrender the

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<sup>89</sup> UMNO's Corporate Cornucopia (13 October 2010). *Asian Sentinel*. Retrieved from <http://www.asiasentinel.com/>

Langkawi land on which the Four Seasons Hotel stands (*The Malaysian Insider*, 25 Jun 2012<sup>90</sup>).

## **6.5 Conclusion**

These four scandals reflect corporate governance failures at the highest level of government and involve key political leaders. While these scandals resulted in substantial losses to investors and taxpayers, they also had social repercussions, including the appropriation of land rights from indigenous communities and serious degradation of the environment. In all four cases, a common feature was the evident abuse of power by politicians in parties within the ruling BN government. What is clear too is that politicians in the hegemonic UMNO have been deeply involved in these scandals. The four case studies illustrate that financial scandals and corruption can occur in any industry and under a variety of circumstances. In order to gain a better understanding the commonalities inherent in these cases, Chapter 7 will analyse them collectively using the logic model of scandal and reform.

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<sup>90</sup> Reveal MAS-Tajudin settlement say Pakatan (25 June 2012). *The Malaysian Insider*. Retrieved from <http://www.themalaysianinsider.com/>.

## CHAPTER 7

### ANALYSIS AND FINDINGS

#### 7.0 Introduction

Chapter 7 extracts cogent thematic areas from the four case studies of corporate scandals and poor corporate governance. These are examined using the logic model framework (see Figure 5.1) incorporating selected components of Sherman's (1978) cyclical scandal-reform model. The four key components of the logic model are: political, social and regulatory institutional contexts, organizational deviance, scandal, and social control.

A cross-case synthesis is conducted to identify common themes drawn from an in-depth analysis of the four corporate case study scandals (see Table 7.1). It then proceeds to develop an understanding of why state corporate governance reforms have failed to prevent a recurrence of business scandals in the country.

Table 7.1  
Common Characteristics in the Cross-Case Analysis and Synthesis

<b>Common Characteristics in the Cross-Case Analysis and Synthesis</b>	
<b>Political Context</b>	<ul style="list-style-type: none"><li>• Crony capitalism</li><li>• State corruption and abuse of power</li></ul>
<b>Social Context</b>	<ul style="list-style-type: none"><li>• Concentration of political power and influence</li></ul>
<b>Regulatory/Control Context</b>	<ul style="list-style-type: none"><li>• Lack of regulatory attention to enforcement</li><li>• Poor oversight of regulatory authorities</li></ul>
<b>Organizational Deviance</b>	<ul style="list-style-type: none"><li>• Deception and manipulation</li></ul>
<b>Scandal</b>	<ul style="list-style-type: none"><li>• Severe economic/social costs</li></ul>
<b>Social Control</b>	<ul style="list-style-type: none"><li>• Selective prosecution</li></ul>

## **7.1 Institutional Context**

The institutional context, laying the foundations for comprehending corporate deviant behaviour and the primary explanatory factors leading to corporate governance reforms, comprises the following dimensions:

1. Political context
2. Social context
3. Regulatory context

### **7.1.1 Political Context**

The political context frames the constellation of political forces emanating from diverse sources which bring pressure to bear on specific desired organizational outcomes (Sherman, 1978). The analytical perspective applied to study of the political context of a scandal reviews the culture of crony capitalism in the four case studies, anchored on the symbiotic links between political and corporate entities, as well as the corrupt behaviour and blatant abuse of power by the state (exercised through political actors) to ensure and influence outcomes favourable to preferred entities.

#### **7.1.1.1 Crony Capitalism**

The evidence of “crony capitalism”, constituting a close nexus between politics and business, in the four corporate scandals is incontrovertible. This nexus is central to understanding the evolution of these scandals, occurring in cahoots with the heavy-handed manipulation of governmental investigative and legal systems in their aftermath. To Sherman (1978), scandals are organizational in nature, implying that their embedded culture can generate social harm while no specific individual or entity can be assigned blame. It is pertinent to observe, too, that such an organizational culture breeds behaviour that is implicitly condoned by state institutions and actors, and is not by any

means only confined to political entities. This is seen to be particularly true of the political parties in the Barisan Nasional, notably UMNO and the MCA, though Taib's Parti Pesaka Bumiputera Bersatu (PBB) and other core parties in Sarawak can be included here. UMNO's hegemonic control over the government, giving it also access to financially well-endowed GLCs (among other bodies), has contributed to the scale and scope of corruption seen in these scandals.

In the cases studied, the state, through various political entities, actors and agents, was the primary decision-making source for allocating rent-creating opportunities to diverse entities in the crony network (without necessarily achieving project goals) because of excessive greed and a blatant disregard for the public good. Ironically, this need not have always been the case. For example, a number of key projects that had been selectively awarded by the government, involving for example the construction of highways, licence to serve as independent power producers (IPP) and to develop telecommunication companies, have been successfully completed with several eventually operating as profitable enterprises. Table 7.2 summarizes the manifestations of this culture of crony capitalism inherent in the corporate case scandals.

Table 7.2  
Summary of Evidence of Crony Capitalism

Case	Evidence of Crony Capitalism
PKFZ	<ul style="list-style-type: none"> <li>• Appointment of BN politicians as PKA board of directors</li> <li>• Appointment of KDSB as turnkey contractor without open tender. KDSB is owned by a BN politician, i.e., Tiong King Sing who owns a 70 per cent stake</li> </ul>
Sime Darby	<ul style="list-style-type: none"> <li>• Initial award of Bakun Dam contract to Ting Pek Khiing's Ekran. Even though project was not completed, Ekran was compensated</li> <li>• Timber rights and NCR "New Land" deals to cronies of Sarawak's Chief Minister Taib</li> </ul>
NFCorp	<ul style="list-style-type: none"> <li>• Contract awarded to Salleh Ismail (husband of UMNO politician Sharizat Jalil). Salleh does not possess prior experience, technical and financial expertise in the cattle and beef industry</li> <li>• Appointment of Salleh's children as board members and management of NFC</li> </ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"> <li>• Privatization of MAS and CELCOM to Tajudin Ramli, a known proxy for the then Finance Minister Daim and the Prime Minister Mahathir. Tajudin had no prior experience in both industries</li> <li>• Government-facilitated bank loan for Tajudin to purchase government-owned shares to take control of MAS</li> <li>• Tajudin awarded MAS-related contracts to his own and family-owned companies suggesting that he saw himself as proxy for UMNO leaders in MAS and could enrich himself (and his mentors) at the expense of MAS</li> <li>• Government bailout of Tajudin at public expense</li> </ul>

The crony capitalism *modus operandi* manifested its strategy in two distinctive ways. First, its operational arms were public agencies (for instance, PKA) or GLCs (Sime Darby and MAS) directly controlled by the government and open to political manipulation by powerful political parties and individuals directly or indirectly involved in the ruling Barisan Nasional and displaying an easy subjugation of the established institutions of state. Political elites have adopted a lead role in the evolution and unfolding of these scandals and ultimately intervene and interfere in the succeeding project implementation and delivery stages (although the attainment of the technical project objectives appears to be a secondary priority). Their grasp of power was such that established governance mechanisms and tools and even fundamental state



institutions could be bypassed, overridden or otherwise manipulated, to the advantage of the favoured beneficiaries from whom a *quid pro quo* would have been negotiated.

Provided with such authority, business people associated with these projects are often beholden to political elites although the former also benefit financially from these projects. There is evidence that these business people serve as proxies for influential politicians, as seen most clearly in the case of MAS and the Bakun project (see Table 7.2). These political elites are empowered to dictate the manner of project implementation and decide how to distribute or re-distribute concessions to favoured and connected individuals, a situation noted clearly in the PKFZ scandal, with diverse MCA politicians holding senior posts in the companies responsible for project implementation.

The PKFZ project, though the responsibility of the PKA (itself a statutory body under the Transport Ministry), was implicitly under MCA control as the Minister of Transport was an MCA nominee who could enable and ensure the exercise of crony capitalism. Interestingly (and symbolizing cross-party trade-offs and negotiations on project benefits), the MCA did not channel project spoils exclusively to party stalwarts but also to regional UMNO (Kapar, Selangor) politicians such as Rahman Palil and Onn Ismail in whose area of influence the PKFZ operated. These UMNO politicians exercised the requisite clout and authority through their senior positions in the Selangor State government.

This multiparty distribution of project spoils extended to a private entity, KDSB, and its beneficial owner, Tiong King Sing, a prominent Sarawak businessman and the Bintulu Member of Parliament. KDSB's appointment as the sole turnkey contractor was without an open tender. Tiong played a critical and central role in the unfolding scandal in the disputed but profitable land sale to PKA which also benefited UMNO and MCA politicians. Following a serious factional dispute in the MCA, prominent leaders, including former party presidents, were accused of accepting huge bribes from Tiong (*Sin Chew Daily*, 15 August 2009<sup>91</sup>).

KDSB's decision to nominate the technical officers (i.e., legal counsel and quantity surveyor) with close ties with KDSB, is aligned to its strategy to ensure leverage over the manner of project implementation and to reap substantial profits, even for work not done! KDSB's appointment ultimately points to Tiong and his ability to manipulate close ties with senior UMNO and MCA politicians to ensure the extraction of numerous rents linked to the PKFZ project. Serious allegations have surfaced of Tiong bribing senior MCA politicians through personal favours (by, for instance, use of a private plane) and project contracts (consultancy contract to then MCA Youth Chief Wee Kia Song). Despite such allegations, no investigation has been instituted, implying political protection by top UMNO leaders who exercise their hegemony over the state to ensure that such institutions as the police or the Attorney General's Chambers are selective in their investigation and prosecution, respectively.

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<sup>91</sup> Tiong: RM 10m was donation for MCA activities! (15 August 2009). *Sin Chew Daily*. Retrieved from <http://www.mysinchew.com/>

Similarly, the Bakun dam project clearly demonstrates the extensive power of the heads of the federal (Prime Ministers Mahathir and Najib) and state governments (Chief Minister Taib). With the onset of the AFC, Mahathir was the ultimate authority to bail out the original Bakun dam contractor, Ekran, and its owner, Ting, a close associate, through the cash-rich, GLC, Sime Darby, a convenient corporate vehicle despite its non-exposure to the power generation industry. Taib significantly exploited his position to award concessions and contracts to family and favoured cronies overriding the indigenous peoples' ancestral land rights.

Given that Sime Darby was a cash-rich GLC conglomerate, the government's decision to involve it in the construction of the Bakun Dam ensured its sustainability. The government permitted the bailing out of Ekran and its owner, Ting, in the form of publicly-funded compensation although the latter was well aware of the project risks when he embarked on the project. Sime Darby's decision to venture into an unfamiliar industry with no proven feasibility and to provide financial compensation to a third party indicates the corporate governance challenges that GLCs and their boards confront when politicians and the executive arm intervene in commercial policymaking. Assessing the implementation of the Bakun dam project indicates the collaboration of federal and regional political elites such as Taib, Sarawak's Chief Minister. Taib was well positioned to allocate lucrative rent-generating opportunities to holding companies owned by his family and cronies. Sime Darby, with its financial resources, was then used to acquire these holding companies at a highly inflated rate.

Crony capitalism employs a different strategy when the state acts as patron dispensing key contracts to private entities owned by politically-connected individuals. Thus, in the NFCorp project, a company with no related business exposure, but intimate family ties to an influential politician, was awarded the feedlot contract. Tajudin, acting as proxy for his mentor, Daim Zainuddin, the former Finance Minister and close associate of Mahathir, was awarded a privatized MAS, a potentially lucrative rent given that this company was a monopoly.

The NFC project was awarded by the government, through MOA, to a private entity, NFCorp, owned by Muhammad Salleh, the husband of UMNO Wanita chief and Minister of Women, Welfare and Community Development, Shahrizat Jalil. This award by the MOA (then under the Deputy President of UMNO and Deputy Prime Minister, Muhyiddin Yassin) to Salleh is highly suspect given the latter's lack of industry and business experience and can only be attributed to Shahrizat's political party and government position. The motive for the award was believed to help cement Shahrizat's and Wanita UMNO's loyalty and commitment to the senior leadership (i.e. Deputy Prime Minister and Prime Minister) consolidating the culture of cronyism in UMNO.

Exacerbating the questionable concession is Salleh's nepotism in employing his children, also without industry experience, in senior NFC positions with superlative salaries. The inefficiency of NFCorp attracted the attention of the Auditor General although it was glaring and highly suspicious that government oversight bodies, like the MOF, and the commercial banks failed to exercise their disciplinary powers when project targets and financial regulations were breached. Corporate governance at the board level was negligent in claiming ignorance of NFCorp's business transactions and

investments. This may well be emblematic of the endemic subservience of bureaucrats and GLCs to influential and highly-placed politicians.

While it is moot if project spoils were further distributed among political elites and grassroots members, NFCorp and Shahrizat received strong support from Muhyiddin and the incoming MOA Minister when the scandal broke, raising suspicions of complicity and crony network behaviour.

The privatisation of MAS by the government to Tajudin and its subsequent financial bailout details the machinations of crony networks as he had no airline management experience but was a “blue eye boy” of Daim Zainuddin, previously Finance Minister in Mahathir’s government. To ensure the privatisation of MAS, the government further intervened in the corporate sector to ensure sufficient financial resources from publicly-listed government-controlled banks were employed to complete the transfer. Like Salleh at the NFCorp, Tajudin enriched himself and family members and associates through self-serving management strategies financially disadvantageous to MAS.

When the MAS scandal surfaced, Tajudin argued that its privatization was an enforced “national service”, concealed within a corporate transaction to appease the investment community and public. Such a claim gains some semblance of credibility as the privatisation exercise was not by open tender. This implied that, despite his apparent majority equity ownership in MAS, Tajudin did not see himself as having ultimate ownership and control. Tajudin later argued that he was a reluctant player but agreed at the insistence of Mahathir and Daim.

Tajudin was an actor controlled and manipulated by the executive arm of the state; however, he abused his authority by self-serving management strategies when he controlled MAS, probably in the belief that he would be protected by his patrons and mentors. Indeed, Tajudin has not been prosecuted for mismanaging MAS through corrupt deals, indicating the possibility that he was privy to secret information detrimental to the interests and position of UMNO's top functionaries. That Tajudin was not charged and prosecuted in spite of overwhelming evidence of abuse of power in MAS, significantly undermining its financial standing, is indicative of the omnipotence of the executive arm over major state institutions. Such cases have fuelled extensive criticism of the practice of "selective prosecution" in Malaysia (Jayasuriya, 2001; Beh, 2011).

Following the AFC, MAS (and Tajudin) carried a heavy debt load requiring its re-nationalization, a move as controversial as its privatisation. Such interventionist strategies reveal that while the state was a patron in awarding lucrative concessions and contracts to favoured business entities and people, it, acting through political elites, continued to maintain control over privatised companies through proxies, such as Tajudin. Proxies such as Tajudin were well aware that the state would dictate key business decisions, irrespective of his apparent majority ownership of MAS.

#### **7.1.1.2 Political Corruption**

The four corporate scandal cases signify extensive and blatant abuse of state executive power, disregarding extant regulations and mechanisms. This is emblematic of political corruption to favour chosen entities and to accrue rents, personally or for political purposes. The award of contracts or concessions to the primary agents facilitated subsequent corrupt actions to favour other secondary cronies, in a phenomenon where

corrupt behaviour engenders further corruption. Table 7.3 itemizes the evidence of political corruption arising from the four case scandals.

Table 7.3  
Evidence of Political Corruption

Case	Evidence of Political Corruption
PKFZ	<ul style="list-style-type: none"> <li>• Political inference to push the dubious land sale by KDSB to PKA at inflated prices and hidden interest rates</li> <li>• Issuance of Letter of Guarantees by Ministers of Transport and the PKA Chairman to KDSB without the competent authority to do so</li> </ul>
Sime Darby	<ul style="list-style-type: none"> <li>• Federal government's directive that Sime Darby be involved in the Bakun dam project</li> <li>• Sarawak State government's decision to award NCR land deals to third parties after earmarking them for Sime Darby, thereby subsequently benefiting the former</li> <li>• Taib's decision to award without tender timber and land concession to cronies</li> </ul>
NFCorp	<ul style="list-style-type: none"> <li>• MOA's decision to award a RM250 million soft loan without due process and before the contract was signed</li> </ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"> <li>• Agreement for indemnity by Mahathir for Tajudin's purchase of the MAS shares</li> <li>• Government decision to instruct relevant GLCs to ignore a court ruling and proceed with an with out-of-court settlement with Tajudin</li> </ul>

In the case of PKFZ, evidence of abuse of power and corrupt practices by key political actors acting on the state's behalf is evident in the Pulau Indah land sale at inflated prices and hidden interest in the deferred payment and Letters of Guarantee by the MOT Minister without federal cabinet consent. Both transactions generated immense profits and spawned subsequent corrupt actions but created a financially unsustainable project that needed a public bailout. Such dubious transactions involving taxpayer funds reflect that the practice and culture of corruption in Malaysia is institutionalized and enabled by the hegemony of key politicians over the different branches of government.

The involvement of cash-rich GLC, Sime Darby, a plantation company, in the Bakun Dam is difficult to rationalize, except as a mega-project that Mahathir desired. Sime Darby led the project, when it initially failed to take off, following government intervention and pressure on its board and management and which may be construed as abuse of power by the Prime Minister. The Bakun dam also involved the Sarawak Chief Minister, who consolidated his position as patron for rent generating opportunities for his crony capitalist network. His position as State Natural Resource Minister allowed him to distribute logging concessions on NCR land, considered inviolable, to family members, particularly through public-listed CMS (Rodan, 2004; Chin, 2004). Taib's family has profited from multifarious state contracts and has amassed an interest in over 300 Malaysian companies.

The RM250 million NFC soft-loan, issued before the formal agreement was signed, raises public sector governance issues pointing at high-level intervention for favoured cronies. As the project went on-stream, further manipulation arose when inherent check-and-balance safeguards were not enforced by the MOF or MOA, a fact traceable to the interference of high-level politicians, including senior ministers. This lack of government oversight over the use of the funds and the failure to adhere to the contractually stipulated governance and reporting mechanisms exemplifies the intervention of the executive arm, acting in concert with senior UMNO politicians.

Tajudin's claim in a court affidavit that the then Prime Minister had directed him to purchase MAS shares as a government proxy and further promised indemnity if necessary is clear evidence of political corruption at the highest government level. The government's subsequent decision that public authorities ignore a court ruling and initiate an out-of-court settlement with Tajudin underlines the existence of rampant



political corruption and the abuse of power and influence. These events also confirm suspicions of self-serving decisions, lack of transparency and unwillingness to recoup corporate losses triggered by inept management and blatant corrupt practices.

### **7.1.2 Societal Context**

The societal context incorporates the ensuing physical, social and economic factors following a scandal (Sherman, 1978): in the four corporate scandals, their interface reflects a concentration of political power and influence in corporate dealings.

#### **7.1.2.1 Political Power and Influence**

The societal context of the case studies underlines a culture of corruption or its tolerance due to the concentration of political power and influence. As a critical governance mechanism, the Boards of Directors did not or could not exercise their authority and independence as board appointments were influenced by key politicians. Such exercise of influence also exhibits the blatant disregard of state players for the integrity of the board and, by extension, their hypocritical call for improved corporate governance. It is also noteworthy that while boards serve to safeguard the welfare of all stakeholders by ensuring that the executives achieve their corporate targets, in the four case studies, board interference was more oriented to maximize unlawful gains and profiteering by those given the license to extract rents; ultimately, the corporation in question suffered unprecedented losses which the government then bailed out using public funds.

Furthermore, the failure – or reluctance – of the ruling Barisan Nasional’s coalition partners to recognise that these companies were not independent of the government in terms of their management, had allowed certain politicians to practice diverse forms of patronage, ostensibly while implementing public policies such as privatisation,

affirmative action or nurturing entrepreneurial domestic companies. Such forms of patronage invariably were detrimental to their financial integrity and had occurred despite the fact that the boards were ultimately legally bound to serve the needs of all shareholders. This also suggests that these boards would not be subjected to prosecution for their poor governance oversight if scandals were exposed. In the case of Sime Darby and MAS, their senior management would publicly disclose that they were acting on the dictates of political elites and could bypass the boards.

This centralization of power in hegemonic political elites is well reviewed in the literature on the nature of the state in Malaysia (see, for example Khoo, 1995; Hwang, 2003) which fosters the attitude that its decisions supersede all others. As boards of these companies are ultimately subservient to the power and influence of political elites, they are powerless to act on their fiduciary obligations to safeguard the welfare of the company and shareholders, resulting in corporate losses or failures. In the case of the Bakun dam project, state intervention and interference at the federal and regional levels were detrimental to the rights of tribal communities while also causing significant environmental damage. The socio-economic repercussions of these scandals constitute the consequences of rampant crony capitalism where profits supersede ethical corporate and state governance. A summary of the examples of the abuse of power and influence to benefit specific entities is shown in Table 7.4.

Table 7.4  
Evidence of Concentrated Political Power and Influence

Case	Evidence of Concentrated Power
PKFZ	<ul style="list-style-type: none"> <li>• O.C. Phang, in her capacity as PKA general manager, made resolutions without the authorization of the PKA board and the relevant government ministries</li> </ul>
Sime Darby	<ul style="list-style-type: none"> <li>• Federal government was able dictate key corporate and business decisions involving Sime Darby in controversial projects at the expense of minority shareholders</li> <li>• Sarawak State government's award of contracts to well-connected business people which were in turn sold to Sime Darby at exorbitant prices</li> </ul>
NFCorp	<ul style="list-style-type: none"> <li>• Salleh and his CEO son took major investment decisions without consulting or obtaining prior approval from NFCorp's board. These business dealings involved the purchase of real estate and other transactions unrelated to NFCorp's core business</li> </ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"> <li>• Utilizing his personal relation with the PM and FM, Tajudin was able to dictate key business decision that were ultimately detrimental to MAS</li> </ul>

The implementation of the PKFZ project was ultimately the responsibility of the PKA board which was accountable to the MOT and the cabinet. The PKFZ scandal is a testimony of the board's incompetence in performing its corporate governance duties and/or that it was an accomplice to the decisions taken or bypassed altogether. The scandal underscores the board's failure in being accountable to its primary shareholders (the State and bond holders) and other stakeholders, primarily due to political manipulation and manoeuvring, emblematic of crony capitalism. The PKA General Manager dictated the key PKFZ decisions without consulting ministry officials and project partners, resulting in JAFZI aborting its 15-year management agreement because of political interference and abuse of power. While it is unclear whether Sime Darby's board or management had any political links, the corporate decisions to be involved in the Bakun dam project can be linked to the Prime Minister to benefit favoured corporate and political figures. That a public-listed conglomerate such as Sime Darby could be involved in a major infrastructure projects without first conducting a feasibility study

raises serious queries about interference in the corporate governance mechanisms and/or a compliant board and management.

Furthermore, the appointment of key GLC executives raises governance questions: Sime Darby's ex-CEO, Zubir, is a known associate of former Finance Minister Mohd Nor Yaakop while the present incumbent, Bakke, is aligned to Najib. Such appointments (including Tajudin in MAS) can ensure that the GLCs are beholden to the executive arm of the state, especially relating to project-linked contracts.

These corporate scandals pinpoint the failure of corporate boards in executing their governance responsibilities. In Sime Darby's case, the board was ignorant of weak and questionable project implementation causing massive losses; the NFC-appointed board members were apparently unaware or were grossly incompetent in pleading ignorance of key business decisions by Salleh and his CEO son. The MAS board, similarly, was unable to question corporate decisions by Tajudin, eventually leading to disastrous financial repercussions for the company.

### **7.1.3 Regulatory/Control Context**

The regulatory/control context investigates the operations of social control mechanisms in the corporate cases, with particular reference to regulatory institutions charged with the enforcement of corporate governance regulations, ultimately safeguarding the public interest. This section will explore the non-functioning of these processes and systems due to interference by political actors.

### 7.1.3.1 Lack of Regulatory Attention to Enforcement

In a review of the regulatory reaction to these corporate scandals, a common theme emerges, i.e., the lack of regulatory attention prior to the public expose despite published reports of the irregularities and misdemeanours. These findings on the paucity of regulatory oversight is summarised in Table 7.5. In all the four case studies, the government had initially denied any wrongdoing and defended politically-connected individuals associated with the projects.

Table 7.5  
Evidence of Lack of Regulatory Attention

Case	Evidence of Lack of Regulatory Attention
PKFZ	<ul style="list-style-type: none"><li>• Special government task force did not pursue an investigation into the scandal as instructed</li></ul>
Sime Darby	<ul style="list-style-type: none"><li>• MACC and police failure to investigate corrupt practices after police reports were made</li></ul>
NFCorp	<ul style="list-style-type: none"><li>• Failure of the police to investigate the background of the NCR “New Deal” project involving cronies of Taib</li><li>• Delayed approach taken by the police, MACC and AG’s Chambers in investigating the scandal, until after the 13th general election</li></ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"><li>• Despite acknowledge by a senior police officer the existence of adequate evidence to charge and indict Tajudin, the state decided ignored the matter</li></ul>

In the PKFZ case, despite the many police reports made about numerous irregularities, little action was initiated by the regulators. The MACC stated in their first investigation in 2004 that it could not identify any evidence of corruption. Even after the scandal broke, the MACC took a very defensive stance when interrogated by the PAC. An MACC director declined to disclose information on the investigation, citing that it was on-going. Such a response should be compared with its behaviour when investigating corruption issues involving the Selangor State government under opposition control: it openly disclosed investigation details raising the suspicion of selective prosecution probably on the directive of the executive branch of government.

On Sime Darby's business dealings with the Sarawak State government, the police failed to carry out a full investigation into the corrupt practices involving cronies such as Chew Chiaw Ann, likely on the behest of political elites such as Sarawak's Chief Minister, Taib. For the NFC, government officials initially brushed off the allegations of mismanagement with senior politicians indicating support, and then called for no further action. Only when incontrovertible evidence of corporate malfeasance was publicized, backed by vocal public pressure, did the Prime Minister authorise an investigation. Nevertheless, the Attorney General's Chambers delayed prosecution till after the 13<sup>th</sup> General Elections, in a strategy that compounds public perception of bias and selective prosecution by Barisan Nasional politicians. In the case of MAS/Tajudin, the executive, despite assurance by then CCID chief, Ramli Yusuff, the existence of adequate evidence to charge and indict Tajudin and his cronies, the Prime Minister decided to ignore the matter.

In all the case studies, it is clear that the relevant regulatory and enforcement agencies acted in a lackadaisical and reluctant manner. The police failed to act against any reports filed against the organizations and individuals involved, even publically stating that there was no evidence of wrong doing. On the occasions that these agencies reacted, the state ultimately ignored such advice to prosecute, compounding their attitude towards investigating crimes. The failure of the relevant public regulatory and enforcement agencies underscores the strong perception that such state institutions have not been objective and independent in their decisions and bowed to the intervention and interference of the executive arm of government.

## 7.2 Organizational Deviance

In reviewing the organizational deviance associated with each corporate scandal, in the greedy pursuit of personal profit, key actors manipulated others through deception, omission or destruction of evidence to cover up wrongdoing. The mandatory oversight over corporate decisions was eroded by political pressure brought to bear on these organizations.

### 7.2.1 Deception/Manipulation

Deception and manipulation practiced by the company insiders were prevalent in the four case studies and are summarised in Table 7.6.

Table 7.6  
Evidence of Deception and Manipulation

Case	Evidence of Deception and Manipulation
PKFZ	<ul style="list-style-type: none"><li>• Non-declaration to government of additional interest in the land purchase by Ministers of Transport and PKA management</li><li>• Issuance of Letter of Guarantee by PKA without consent of relevant ministries</li><li>• Appointment of non-independent quantity surveyor and lawyer</li></ul>
Sime Darby	<ul style="list-style-type: none"><li>• Over-paying for purchase of land originally ear-marked by the state for Sime Darby. This land was first channelled to cronies of the State's Chief Minister</li></ul>
NFCorp	<ul style="list-style-type: none"><li>• RM250 million soft loan utilised without due process</li></ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"><li>• Tajudin entered into business deals in which he personally profited at the expense of MAS</li></ul>

In the PKFZ case, several business decisions provide an indication of improper governance: the Managing Director issued Letters of Support without government approval while the purchase of the Pulau Indah land at an inflated price was manifestly against the company's financial interest. Also, the PKA decision to appoint a land surveyor having a material connection to KDSB reflected gross negligence on the part of the PKA board.

In NFCorp, the decisions to purchase expensive real estate and other luxuries directly profited key company executives at the expense of the project funds, indicating a blatant abuse of state-sponsored projects. In the MAS case, Tajudin had entered into unprofitable MASKargo contracts which benefited him and his family while his devious strategy of selling MAS aircraft to his own company for leaseback to MAS profited him while financially disadvantaging MAS which he apparently owned.

### **7.3 Scandal**

A scandal infers the revelation of a major misconduct with severe consequences to the public interest. The backlash to the corporation involved is an essential element of the scandal, without which effective mobilization of social control and reform would be improbable (Sherman, 1978). This section first discusses the economic and social cost associated with the four projects and then goes on to examine the cost to society arising from weak and inefficient implementation and oversight over relatively viable projects.

#### **7.3.1 Severe Economic/Social Costs**

A scandal can be used to initiate a social controversy, due to public discovery of deviant behaviour, stirring intense outrage by the public at large. Scandals are characterized by public anger, surprise at an unexpected corporate deviance, and a sense of betrayal due to a breach of faith by a person holding a position of trust. In examining the society's reaction to the corporate scandals examined in this study and the costs incurred, the major consequence is a tangible deterioration in public confidence in the government and the state institutions involved; in the longer term, the general public has adopted a cynical perspective of the government's decisions even if they appeared to be rational, logical and transparent. The Barisan Nasional's performance since the 2008 general election has exhibited a continuing political decline in its support particularly among the



young Malaysians with little memory and less regard for ethnic politics and horse trading. Much of this deterioration can be attributed to public exposure of serious corporate crimes and scandals during the build-up of the 2013 General Elections. Public debates about the PKFZ and NFCorp projects contributed tangibly to undermining the credibility of the Barisan Nasional in the 2013 general election, particularly after Najib Razak publicly undertook to attack rent-seeking behaviour and patronage when he became Prime Minister in 2009. One of the key reasons for this serious political backlash is not only the massive amounts of public money involved, but the high profile of key actors, politicians and businessmen, caught up in the web of scandals.

Pervasive corruption and recurring corporate scandals were significant talking points when assessing Barisan Nasional's record of public and national governance standards and quality. Coupled with stories of fraud, political corruption, lavish lifestyles and misuse of taxpayer subsidies, the average Malaysian has voiced his/her disgust and anger in a multiplicity of forums and media including online forums and large-scale public rallies. One prominent movement is BERSIH whose rallies have attained a global dimension, with similar demonstrations by Malaysians residing in major cities in Europe, Australia and North America.

These four corporate scandals have inflicted severe economic costs on the public and the government which are summarised in Table 7.7.

Table 7.7  
Evidence of Severe Economic and Social Cost

Case	Evidence of Severe Economic Cost
PKFZ	<ul style="list-style-type: none"> <li>• Project cost escalation up to RM12.5 billion</li> </ul>
Sime Darby	<ul style="list-style-type: none"> <li>• Displacement of over 10000 indigenous peoples from their traditional settlements</li> <li>• Huge losses due to unauthorised business deals</li> </ul>
NFCorp	<ul style="list-style-type: none"> <li>• RM250 million project is now deemed a failure and the government is seeking a foreign partner to bail it out</li> </ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"> <li>• RM8 billion in losses</li> <li>• MAS has yet to recover its financial standing, posting annual losses</li> </ul>

The PKFZ project was initially estimated to involve RM1.1 billion of public funds but has since escalated to over RM4.6 billion, even after the Cabinet directive that it be self-reliant and sustainable. Due to the dire financial health of the project, the government was forced to inject RM1 billion due to the PKFZ's dire financial situation. Furthermore, as the project currently only enjoys a less than 20 per cent occupancy rate and due the issuance of fraudulent government Letters of Guarantee, the project can possibly balloon to over RM12.5 billion (PwC, 2009). It is projected that PKFZ will only be able to return to the black in 2041.

Sime Darby's foray into the Bakun dam project led to its first loss since the 1997 AFC. Attempts to dispose of the project and relinquish its interests in the energy sector have not been finalised. The Bakun dam project has also incurred a massive social cost due to the physical displacement of 10,000 indigenous peoples. NFC's losses amounting to RM250 million have been projected, although the project was deemed viable; however, the gross abuse of power and corruption by Salleh and his family has caused its failure. In the case of MAS, after awarding control of the company to Tajudin, it is speculated that the airline company suffered losses amounting to RM8 billion. The economic

health of MAS has since not recovered and losses over the past few years have been reported.

The preceding sections have largely focused on the contributing factors and the costs of the four scandals. These have provided the foundation for the examination of the societal responses to those scandals, which will now be the focus of the analysis divided into two parts: social control and reforms.

## **7.4 Social Control**

Social control mechanisms employed in the wake of the four controversies address the scandals through the medium of existing statutes or control systems within an industry or organization. This section will illustrate the exercise of these social control mechanisms and analyse similarities and differences in the various policy responses. Social controls lead to public investigations into the configuration of the scandal and the subsequent punishment and penalties imposed on those involved through organizational sanctions, individual sanctions, or both (Sherman, 1978). The common factor discovered in the exercise of social control mechanisms is the state's preference for selective prosecution of the wrongdoers.

### **7.4.1 Selective Prosecution**

The reaction and response of the state to the four corporate scandals is shaped by its manifest desire to protect favoured individuals (see Table 7.8). The state's initial response to the public exposure of the scandals has been marked by denial in some cases followed by slow and indecisive action because of the prominence of the actors involved in the projects.

A core issue that emerges from Table 7.8 is the systematic manner in which the government has prosecuted the whistle-blowers who publicized the scandals, even though it had introduced a Whistle-Blowers Act to curb corruption and improve governance mechanisms.

One of the frequent criticisms of Malaysia’s corporate reform and anti-corruption strategy has been that its regulatory institutions have been unable to operate independently and effectively. With respect to the high profile corruption cases, it is often alleged that such regulatory institutions have focused on catching the “small fry” and not the “whales” in political, business and administrative circles (Siddiquee, 2005). This is not an exaggeration as most of the corruption cases investigated and acted on by MACC and the police led to prosecution of lower level officials, despite corruption allegations against prominent political, business and administrative elites.

Table 7.8  
Evidence of Selective Prosecution

Case	Evidence of Selective Prosecution
PKFZ	<ul style="list-style-type: none"> <li>• While charges were brought against six individuals, the authorities did not pursue action against KDSB’s owners</li> <li>• Acquittal of Ling after prosecution failed to prove the case against him</li> </ul>
Sime Darby	<ul style="list-style-type: none"> <li>• Charges only against the Sime Darby CEO (not the Board of Directors chaired by an ex-deputy Prime Minister)</li> <li>• No action against Taib and his cronies</li> <li>• Civil suit against Claire Newcastle Brown (Sarawak Report and Radio editor), the whistle-blower</li> </ul>
NFCorp	<ul style="list-style-type: none"> <li>• Charges were only brought against Salleh, after the persistent public allegations by opposition members</li> <li>• Government decided to prosecute Rafizi Ramli for exposing financial mismanagement in NFCorp</li> </ul>
Tajudin Ramli/MAS	<ul style="list-style-type: none"> <li>• Political intervention forced Danaharta to accept an out-of-court settlement with Tajudin in February 2012, against a High Court ruling ordering Tajudin to pay RM589.14 million</li> </ul>

Since the breaking of these scandals, several individuals have been charged and taken to court. In the case of PKFZ, of the six individuals charged, two are former MOT Ministers. However, recent testimony by the then Prime Minister, Mahathir that he did not feel cheated, resulted in the acquittal of a former Transport Minister Ling in October 2013. This acquittal may well be a precedence for the acquittal of the others charged. Furthermore, the failure to charge individuals such as Tiong King Sing and UMNO leaders who have benefited from the project illustrate the nature of selective prosecution. It is arguable that the government consciously decided to only charge non-relevant former politicians and not key players involved to appease the public and prevent the uncovering of the nexus of corrupt practices and patronage in political and corporate circles. Such revelations involving UMNO members particularly would have exacerbated deep factionalism in the party as when prominent UMNO functionaries were arrested for corruption and conflicts-of-interest.

In the Sime Darby case, its board identified former president and CEO, Ahmad Zubir, as the culprit for the corporate losses incurred. Ahmad Zubir has since been confronted with criminal charges while the board has instituted a civil suit against him. One burning issue in the Sime Darby case is why no criminal charges have been directed at Taib and his cronies as the NCR for the Bakun dam project had been earmarked for Sime Darby but sold to a third party (and a crony) for on-selling to Sime Darby at a huge gain. Taib, as the State's Chief Minister and resource planning and finance minister, has been under an MACC investigation since 2011, but no charges have been brought against him. Interestingly, Clare Rewcastle Brown, editor of whistle-blower website Sarawak Report and Radio Free Sarawak, was denied entry into Sarawak when

she attempted to return to Sarawak to prepare her defense for a defamation suit brought against her (*The New York Times*, 16 August 2013<sup>92</sup>).

Salleh has since been charged in court over the NFC's mismanagement of project funds, but other key management officials (i.e. Salleh's children and NFCorp directors) have not been accused of any criminal offence or dereliction of duty. However, Rafizi Ramli, the whistle-blower, was charged under the BAFTA Act for exposing confidential bank documents. He has been denied the right to use the Whistleblower Act 2010 as it was argued that he was not an NFC employee. His prosecution backfired as he was elected Member of Parliament for a Kuala Lumpur constituency during the 2013 general election.

Where MAS is concerned, although the former CCID chief, Ramli Yusuff, had advised Prime Minister Abdullah that the police had sufficient evidence to criminally charge Tajudin, the latter was never arrested or charged, clearly due to political interference. In his report to MACC, the then MASKargo managing director, Shahari Sulaiman, noted that the then CCID director, Ramli, had "disclosed that various offences have been identified that are prosecutable" (*Malaysiakini*, 23 February 2012<sup>93</sup>). The CCID director also assured the then Prime Minister that the CCID had qualified lawyers in its ranks to serve as prosecuting officers if the Attorney General was reluctant to prosecute these offences.

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<sup>92</sup> Barred From Malaysia, but Still Connecting With Critical Jab (16 August 2013). *The New York Times*. Retrieved from <http://www.nytimes.com/>.

<sup>93</sup> Is Tajudin squeezing someone powerful? (23 February 2012). *Malaysiakini.com*. Retrieved from <http://www.malaysiakini.com/>.

Based on the RM1.8 billion losses suffered by MAS, Danaharta initiated civil charges against Tajudin who was liable for RM580 million in damages. When appealing his conviction, Tajudin claimed that he had an “Overriding Agreement” from Mahathir indemnifying him against any losses suffered as he had acted as a proxy for UMNO leaders. The government then instructed that an “out-of-court settlement be reached” and to write off Tajudin’s RM580 million judgement debt. An undisclosed agreement was reached between Tajudin and Danaharta and the government further instructed all GLCs that had filed cases against Tajudin to stop pursuing them. The government’s decision to settle the matter out-of-court raises uncomfortable question of integrity, propriety, accountability and transparency on the part of specific state institutions and the executive branch of government.

## **7.5 Conclusion**

The review of these four corporate scandals generates analytical insights into the failure of the corporate governance reforms instituted after the 1997. Applying a cross case synthesis framework based on a logic model (Figure 5.1), common themes have been extracted from the four corporate scandals. A dominant issue uncovered in this analysis is the overarching institutional framework within which these corporate scandals in Malaysia have been fostered: in particular, this pertains to the nexus of linkages between and among the governing political elite and business class. This chapter has also illustrated that, due to political interference and intervention, the regulatory and investigative agencies of the state have not been allowed to operate with autonomy and independence resulting in selective or no prosecutions at all. Exacerbating this phenomenon of the hegemonic powers vested in the senior political party, UMNO, whistle-blowers have themselves been prosecuted in a “shoot the messenger” strategy, ironically under the shield of a Whistleblower’s Act. Through an analysis of these

scandals, this study has generated analytical insights into the distribution of power in Malaysia's governing structure together with its extensive and illegal manipulation of state institutions for its own political agenda and that of its cronies. A more in-depth exploration of the failure of corporate governance reforms to prevent the recurrence of business scandals in Malaysia will be the prime concern of the final chapter.



## CHAPTER 8

### DISCUSSION AND CONCLUSION

#### **8.0 Introduction**

This final chapter reviews the assessment of the recurrence of corporate scandals and governance reforms in Malaysia and positions it within the scope of academic discourse on the topic. The research problem is then framed against the broad theoretical canvas of corporate governance and reform. Following this, the related context in Malaysia is summarised, within the evolution of its model of political economy with a focus on the core policy formulations that laid the foundations for the rise and entrenchment of crony and relationship capitalism in the country. The ensuing research questions are then stated and discussed. This chapter is rounded off by identifying the limitations of this thesis and projects future research in this critical area of corporate and institutional governance reforms.

#### **8.1 The Research Problem**

The focus of this study is the recurrence of corporate scandals in Malaysia which are emblematic of firm-level failures of corporate governance that have contributed to significant national costs. These scandals have also meant that Malaysia is losing its attractiveness as an FDI destination, while its sovereign credit rating and competitiveness as a trading nation have also be undermined. As with many other nations, cyclical corporate governance reforms have been assiduously instituted by the state but they have not been effective, resulting in the continued prevalence of scandals implicating high-profile and politically-connected companies, among others. Inadequate governance frameworks and lackadaisical or self-serving enforcement are reasons for

the persistence of corporate scandals. Indeed, much study has appropriately been directed to enhancing the effectiveness of both governance frameworks and enforcement in the developed and emerging nations.

A different analytical perspective, adopted in this study, develops the contextual frame of this phenomenon, situated in the nature and evolution of Malaysia's political economy (broadly defined as a composite pattern of its political, economic and social systems and institutions). It is postulated that Malaysia's political economy has so evolved that hegemonic power is exerted by the executive arm of government, which has overshadowed, subjugated and intervened in the normative checks and balances of legislative and administrative institutions that define a mature democratic state. As the cross-case studies investigated in this thesis argue, the ruling political institution, Barisan Nasional, in power since Independence in 1957, displays excessive influence on the corporate arena. Within the Barisan Nasional, the prime source of hegemonic power is UMNO, historically the senior partner in Malaysia's coalition government.

The developmental state model adopted by Malaysia (and many emerging East Asian nations) favoured nurturing domestic enterprises in a diverse range of sectors to drive economic growth. However, one defining outcome of this fostering of domestic enterprises, done in a highly selective and non-transparent manner, has been the rise of politically-connected businesses. The four case companies examined in this thesis are prime examples of crony or relationship capitalism, framing the mutually beneficial interests and goals of the governing political parties and well-connected businessmen, expressed in patronage and rent-seeking opportunities and behaviour.

## **8.2 Research Questions**

### **8.2.1 Research Question 1: Given the research on corporate governance and its failures, what has been the nature of corporate governance reforms in the United States, United Kingdom, Australia and the emerging economies, including Malaysia?**

Corporate governance, according to Monks and Minow (1995:1), prescribes “the relationship among various participants in determining the direction and performance of corporations. The primary participants are the shareholders, the management and the Board of Directors.” Effective corporate governance ensures efficient resource use by enterprises and the larger economy, establishes standards of corporate behaviour attractive to investors, both domestic and international, requires adherence to society’s laws and expectations, and abjures business-linked corrupt behaviour.

Van Apeldoorn et al.’s (2003) review of the political economy of corporate governance regulation concludes that many studies are highly normative and prescriptive or focus primarily on firm-level governance practices or missteps. The literature thus is biased towards those theories or models examining relationships among parties responsible for or affected by governance practices. These include agency theory which pertains to the costs of aligning the managerial behaviour of agents with goals of the principal-owners, assuming selfish motivations of the former. Stewardship theory is formulated on criticisms of the lack of consideration of the sociological and psychological contexts of principal-agent relationships and assumes their inherent mutual trust and cooperation. Stakeholder theory extends corporate responsibility and accountability to shareholders, employees, suppliers, customers, creditors and society at large. These three models have been extensively applied to clarify and rationalise the limitations of corporate governance regimes in countries which have variously adopted the equity market-based

governance model (EMS), bank-led governance model (BLS) or family-based governance system (FBS). The EMS is an Anglo-American governance system where investors exert power the valuing and purchasing of the corporation's securities. However, corporate ownership and control in the "insider" system in Europe is vested in a minority of investors with a plurality of interests (Mayer, 2000) in contrast to the United States where equity in the "outsider" system assigns corporate ownership to a larger diversity of investors. In the BLS model, where banks monitor firm governance, the approach diverges from the Anglo-American model where there are many publicly-traded enterprises and relatively dispersed shareholdings, and the German and Japanese contexts (also termed the "Rhineland" model) with their more concentrated ownership and more significant governance roles exerted by the banks. In the FBS proposed by Khan (2003), East Asian family businesses tap internal or external financing sources contingent on their growth stage but retain corporate control.

This suggests that while the composite focus of these theories converges on firm-level governance, which is not inappropriate and generates useful and critical insights to strengthen corporate governance and its regulation, national growth paths and institutional environments possess a solid bearing to the generic application of corporate governance in any specific nation. Thus, this thesis explores the wider facets of corporate governance fostered by political economy institutional theory and the new institutional economics (NIE) which examine how economic gains are generated in specific institutional environments. Aoki's (2001:281) defines the new institutional perspective of corporate governance as "a set of self-enforceable rules (formal and informal) that regulate the contingent action choices of the stakeholders (investors, workers and managers) in the corporate organization domain". One variant of the institutional perspective of corporate governance is the promising "actor-centred

institutionalism” (Aguilera and Jackson, 2003) which perceives firm-level corporate governance practices through the institutional lens to analyse how actors’ interests are socially constructed and enacted. This model bridges the gap between the gap between agency theory which projects “an under-socialized view” and the “over-socialized” view of institutional theory (Aguilera and Jackson, 2003). Nevertheless, the institutionalist framework avoids the conflict between shareholder-value and stakeholder-society views projecting a comparative dimension of governance mechanisms, labour transactions, political regimes, etc. (Sato, 2004).

Further elaboration is given by the political framework perspective where corporate governance is functionally related to specific institutional configurations (Aguilera and Jackson, 2003; Aguilera, 2005) which can be more insightfully illuminated by exploring the politics of corporate control (Thompson and Davies, 1997) and the impact of the political environment on markets and corporate governance instruments. Corporate governance viewed in isolation projects an incomplete comprehension of its complexity: its fuller exploration must invoke the political model of the state as an overarching framework of political, legal or regulatory nature governing the allocation of corporate power, privileges and profits at the micro level (Turnbull, 1997; see also, (see also, Roe, 1996, 2003, 2006; Gourevitch and Shinn, 2005; Coglianese, 2007; Beloc and Pagano, 2009; van der Wall and Ruis, 2003; Ludvigsen, 2010). This area is under-researched and provides the rationalisation for the qualitative approach to examine corporate scandals in Malaysia on a cross-case basis transcending the firm-level approach traditionally adopted in the literature.

### **8.2.1.1 Nature of corporate governance reforms**

The nature of corporate governance reforms reflects the diversity of its conceptualization and application in different countries which are contingent on conventions, environment, worldview together with “culture, democratic representation and accountability, the distribution of power, and the protection of property rights and equality” (Sison, 2000:181). Other perspectives consider the state of press autonomy and business rivalry (Zingales, 2000) and the political process accommodating powerful and influential entities in the economy as in the United States, Japan or Germany (see among others, Roe, 1994; Gerschenkron, 1962). The United States, United Kingdom, Germany and Japan have among the best global corporate governance systems although they are, by no stretch of the imagination, perfect. In contrast, the emerging and transition economies where corporate governance frameworks are poor or virtually absent (Schliefer and Vishny, 1998), confront a steep learning curve primarily reflective of their weak institutional framework. In Malaysia, tangible attempts have been made to enhance corporate governance post-AFC, by energizing its regulatory environment to decrease market vulnerability to future shocks, reinforce property rights and reduce transaction and capital costs (World Bank, 2005). Among the policy initiatives were the High Level Finance Committee set up by the Dewan Rakyat in 1998 which released a spate of governance reforms through the Securities Commission, Bursa Malaysia and Registrar of Companies, the major ones of which were the Malaysian Code of Corporate Governance (MCCG). Important institutions were established including the Malaysian Institute of Corporate Governance in 1998 and the Minority Shareholder Watchdog Group in 2000, while the Putrajaya Committee on Government-Linked Companies (GLCs) High Performance was announced in 2006 in order to enhance GLCs’ governance.

### **8.2.2 Research Question 2: What are politically-connected businesses in the context of States practising crony or relationship capitalism and the nature of rent-seeking behaviours that are engendered and supported?**

Based on several scholars (Faccio, 2006; Gomez and Jomo, 1997; Johnson and Mitton, 2003), politically-connected companies, defined as controlling shareholder with specific links to the political infrastructure either personally, directly or indirectly, received preferential treatment, consolidating their competitive advantage (Kali, 2001). Their major motives include rent seeking, extraction and protection (Schleifer and Vishny, 1998; Agarwal and Knoeber, 2001), facilitated by state interventions in multiple formats, including favourable regulatory conditions (Agarwal and Knoeber, 2001), discounted credit and import licenses (Mobarak and Purbarsari, 2006), capital controls (Johnson and Mitton, 2003), financial bailout (Faccio et al., 2006), preferential access to debt financing (Khwaja and Mian, 2005), preferential bank loans (Sapienza, 2004), higher leverage ratios (Faccio, 2002) and lower taxation and greater market power (Faccio, 2002).

Crony or relationship capitalism in East Asia is anchored in the development state model espousing proactive state intervention as a catch-up growth strategy; its hallmark is the nexus between the state and business, using the instrument of GLCs, and, in some cases politically-linked enterprises. State patronage is often self-serving as postulated by Grossman and Helpman (1992) as political entities “sell” protection and preferential treatment to corporations for campaign funding. Politically-favoured firms clearly benefit under crony capitalism at the expense of their unconnected competitors; the social costs can be burdensome, sometimes even to the beneficiary companies which sacrifice efficiency and profitability (see, among others, Yoshihara, 1988; Schleifer and

Vishny, 1994; Bushman et al., 2004; Acemoglu and Johnson, 2005; Fan et al., 2007; Chaney et al., 2011; El Ghouli et al., 2011; Guedhami and Pittman, 2006).

Malaysia's corporate sector environment favours politically-linked companies (Gul, 2006). Between 1997 and 2002, Faccio et al. (2006) estimates that Malaysia had 81 such corporations, that they were well represented in all major economic sectors and accounted for one-third of Bursa Malaysia's 757 listed companies and constituted greater than a fifth of its market capitalization (Gomez and Jomo, 1997; Searle, 1999). Three types of politically-connected firms exist: the directly state-owned and managed government-linked corporations (GLCs), those directly or indirectly owned by the political parties, especially UMNO and MCA; and those owned by well-connected corporate figures.

The surge of these favoured enterprises in Malaysia can be traced to the New Economic Policy which aimed at a more impartial dissemination of the nation's affluence, especially targeting the Bumiputera community. By the early 1980s, the GLCs and their joint-ventures with favoured private companies became prominent players in the economy underscoring the political-business nexus, one key pillar of crony capitalism (Johnson and Mitton, 2003; Gul, 2006). A second pillar was the privatisation policy pursued by Prime Minister Mahathir Mohamed in 1983 to reduce public-sector participation in such sectors as infrastructure and utilities and to encourage home-grown capitalists. Between 1983 and 2009, 500 privatised projects were launched ([www.ukas.gov.my](http://www.ukas.gov.my) accessed on 29 May 2014), while 401 companies were listed on the Main and Second boards between 1984 and 1996. By 1995, Bursa Malaysia was ranked third largest in the Asia Pacific after Hong Kong and Sydney. Allegations of extensive political nepotism and cronyism arose with the implementation of privatisation,



alongside extensive illustrations of corporate misbehaviour and mis-governance (Ismail, 1991; Abdul Samad, 2004).

### **8.2.3 Research Question 3a, b and c**

**Research Question 3a: Focusing on the evolution of politically-linked corporations in Malaysia with special reference to a cross-case study of Government-Linked Corporations (GLCs), what are the essential dimensions of crony capitalism as they impinge on governance issues?**

**Research Question 3b: What has been the nature of the state's responses to these major corporate scandals?**

**Research Question 3c: Have the state's responses been effective in mitigating damage and harm to society and laid stronger institutional foundations to anticipate corporate governance misbehaviour?**

For convenience, the study findings pertaining to the first three sub-parts of Research Question 3 will be discussed together rather than individually as they are intertwined. Using case study methodology, the four cases were selected and secondary material gathered and analysed framed by Sherman's (1978) scandal and reform logic model to surface themes fundamental across all the cases. The four case companies chosen were Port Klang Free Zone ( a statutory government corporation), Sime Darby Berhad (a GLC), National Feedlot Corporation ( a statutory government agency) and Tajudin Ramli/Malaysian Airlines Systems Berhad (a GLC nominally privatised to Tajudin Ramli proxy for a serving Finance Minister and UMNO stalwart and intimately connected to the then Prime Minister). These cases were investigated using a qualitative approach to accumulate an extensive body of data from which to analytically extract the core attributes of crony capitalism arising from the governance scandals in each

case, the nature of the state's responses to these corporate scandals, the effectiveness of the state in dealing with the scandals, and, if their efficacy was questionable, what factors could account for the discrepancy between measures nominally enforced and their normative outcomes. Sherman's (1978) model postulates that organizational deviant or aberrant behaviour reflects untoward movements away from established societal norms or standards which in an open society causes a public scandal. Its originating causes, it is further postulated, are located deeper than what the scandals superficially suggest causing pressure to be brought to bear on the state, through its established institutions, to initiate reformative measures because of the intense social tensions too challenging to avoid or overcome. The four cases, studied individually or on across cases, portray corporate scandals driven and exacerbated by state or political intervention diversely configured, which, through social pressures force state institutions to undertake corrective action and reform.

Based on Research Question 2, the prime policy drivers for the introduction and prevalence of politically-linked companies in Malaysia are the New Economic Policy and the privatisation policy embedding into the corporate culture the crucial significance of connections and relationships between entities and personages in powerful political, related positions and businesses. The manifestations of crony or relationship capitalism emanating from the cross-case studies and the nature of the state's responses to the ensuing scandals assessed in Chapter 6 and critically evaluated in Chapter 7, can be summarised as follows:

1. Issues of corporate governance deviant behaviour are primarily grounded in the power inherent in the institutional framework of the state and are theoretically rooted in the institutional (or contextual or "socialized") perspective of corporate

governance. The most promising development of this framework in the literature (insofar as this thesis is concerned) revolves around the politics of corporate control and its impact of the political environment on markets and the framework of corporate governance in a specific economy. Moreover, the liaison between the political entities and businesses is symbiotic as state or political patronage of enterprises becomes a requisite source of financial resources to fund political campaigns.

2. Arising from the cross-case synthesis and applying Sherman's model, the institutional environment comprises the political context, social context and the regulatory context; it is manifest that, in Malaysia, the substantive nature of national governance is contingent upon the political context whose power and influence are normatively moderated and balanced by the primary institutions of a mature democratic state. The locus of political power and influence is the Barisan National, in power since Independence, and, within it, the traditional, sacrosanct and hegemonic *primus inter pares* status of UMNO. The extent of that power is uncovered by the four cross-case studies.

The nature of the political context of the case studies is defined by the mechanisms or *modus operandi* by which crony capitalism is conducted and consolidated by the corrupt use of political power. Crony capitalism is fostered primarily by the award of lucrative contracts to the ruling Barisan Nasional component parties (UMNO and MCA) and preferred and politically-connected entities, directly or indirectly, whether involving statutory corporations (PKA and NFC) or GLCs (Sime Darby or MAS). The strategy of crony capitalism blatantly ignores the need for prerequisite business experience and exposure to

provide some degree of project competency and project sustainability: such unlawful decisions are surfaced in the pressure to off-load the aborted Bakun dam project on Sime Darby, the award of NFC to the husband of UMNO Wanita and the PKFZ to KDSB and the privatisation of MAS to an investment banker. Ironically enough, crony capitalistic strategy is not grounded on the priority to deliver successful project outcomes and proper implementation in all the four case studies; it becomes not unreasonable to suggest that the public good is not the highest policy priority in such projects but their instrumentality in generating economic rents and political pay-offs. It is even more ironic that sometimes project losses incurred by a crony are reimbursed using public funds (as in Ting Pek Khing's case or the re-nationalisation of MAS after Tajudin's disastrous tenure as its managing director)

The award of lucrative state projects to the original entities spawns a secondary round of corrupt behaviour and beneficiaries in all the four case studies: in effect, corruption and corrupt behaviour at the highest levels engender similar deviant culture at lower levels. Opportunities for harvesting economic rents recur systemically as in the "flipping" of land allocated to a Fishermen's Association through local UMNO politicians to KDSB or the logging concession on indigenous peoples' ancestral and communal land in Sarawak to cronies of the Chief Minister and the dubious and self-dealing application of project or corporate fund for the personal or family benefit of Salleh Ismail (NFC) and Tajudin (MAS).

In all the four cases, crony capitalism not only enables the non-transparent allocation of projects and concessions to preferred entities and individuals; it

systematically entails the unlawful intervention and interference by the state in project implementation by overriding established governance regulations and mechanisms.

3. The societal context incorporates the ensuing physical, social and economic contextual facets ensuing from a scandal (Sherman, 1978): in the four corporate scandals, their interface reflects a concentration of political power and influence in corporate dealings. As a critical governance mechanism, the Boards of Directors did not or could not exercise their authority and independence as board appointments were influenced by key politicians in blatant disregard of its integrity and their hypocritical avowals supporting improved corporate governance quality. It is also noteworthy that the corporate boards were driven to maximize unlawful gains and profiteering by those given the license to extract rents. Thus, it is not unreasonable to surmise that these boards acted in the belief that they would not be subject to prosecution for their poor governance oversight if scandals were exposed. In fact, in the Sime Darby and MAS case studies, senior management publicly disclosed that they acted on the dictates of political elites and could bypass the boards.
4. The regulatory/control context pertains to the social control of corporation, specifically the regulatory institutions enforcing corporate governance regulations. One common and glaring theme that emerges is the patent reluctance for corporate enforcement despite published reports detailing deviant behaviour. In all four case studies, the government's knee-jerk reaction was denial of any wrongdoing complemented by a hasty defence of the politically-connected individuals or entities associated with the projects.

5. Organizational deviance associated with each corporate scandal was fostered by key actors who manipulated others (wittingly or unwittingly) through deception, omission or destruction of evidence to cover up wrongdoing eroding the instruments of corporate oversight over enterprise decisions as detailed in Table 7.6.
  
6. The ensuing corporate scandal involving the public revelation of major organizational misconduct severely corroded public interest and welfare and provoked a backlash strong and significant enough to initiate the effective mobilization of social control and reform (Sherman, 1978). The corporate scandals analysed involve significant economic and social costs to society (enumerated in Table 7.7) because of weak and inefficient enforcement and oversight over relatively viable projects. The erosion of public support for the Barisan Nasional is attributable in no small measure to public exposure of serious corporate crimes and scandals before the 2013 general elections especially linked to the PKFZ and NFCorp projects conflicting with the public disavowal of rent-seeking behaviour and patronage when Najib became Prime Minister in 2009. The significant political backlash was not only due to the massive wastage of public resources but the highly placed key actors, politicians and businessmen involved.

### **8.2.4 Research Question 3d: What are the critical institutional weaknesses contributing to the ineffective implementation and enforcement of proper corporate governance and its recurrence?**

In reviewing the corporate scandal case studies applying Sherman's (1978) conceptual model of scandal and reform, the key perspectives in analysing the state-initiated corporate reforms are:

- 1) symbolic reforms;
- 2) strong political-business linkages; and
- 3) weak state institutions.

#### **8.2.4.1 Symbolic Reforms**

The corporate governance reforms instituted to prevent the recurrence of the post-AFC financial fiascos resemble "quick and easy band-aid" prescriptions to manage public perceptions more than concerted strategies acknowledging and incorporating their contextual attributes. Based on the four case studies, the state-sponsored governance reforms appear to be mere reactions to extensive and negative foreign and domestic criticism. An analogous phenomenon examined by Clark et al. (2005) of the Dutch Royal Ahold scandal postulates that its swift reaction to enhance company transparency and governance standards was directly linked to the dramatic decline in international investor confidence.

The Malaysian governance reforms constituted symbolic legislative creations avoiding critical structural and institutional issues inherent in its political economy, particularly the institutionalisation of crony capitalism and the culture of corruption in the body politic. Despite the studious bypassing of this seminal issue, the impression was given of the state's unwavering commitment to investors' interests and concerns. At the

scandal's outbreak, strong external pressure by investors and international bodies forced urgent corporate reforms by the state; once the economy stabilized (and investor pressure waned), the will to enforce governance reforms correspondingly diminished. As corporate reforms advanced through the legislative process, their punitive intent was diffused by a raft of negotiations and compromises to appease and protect special political-business interests. The exercise of patronage and rent-seeking behaviour remains deeply entrenched in the conduct of politics in UMNO (and its partners). Given UMNO's hegemonic position in the state, party members are unlikely to passively acquiesce to the reformatory strategies applied by the executive arm of government to attract domestic and foreign investments and to generate economic growth.

#### **8.2.4.2 Strong political-business linkages**

A second reason why corporate reforms have proven futile and toothless is the unwillingness to resolve the conflicts-of-interest situations faced by its regulatory and enforcement bodies. Recalling the AFC, the World Bank (1998: 67-68) thus noted that: "Regulators responsible for monitoring and overseeing such practices failed to detect weaknesses and take timely corrective action." Interestingly enough, Malaysia has introduced oversight institutions and corporate governance models similar to those adopted in Hong Kong and Singapore; the two nations have curbed corruption significantly and their anti-corruption agencies are directly responsible to the head of government. This study argues that the failure of governance reforms and the recurrence of corporate scandals is directly associated with the lack of autonomy of the regulatory agencies and their manipulation by the executive arm of the government for personal, organizational or political profit.



Such manipulative strategies is consistent with Blair's (1995) proposition that while corporate governance vests in the board of directors the ultimate power to protect shareholder rights, this mechanism has been forced upon firms by state institutions and agencies overseeing the regulation of enterprises and corporate behaviour; this, however, does not necessarily apply to well-connected companies unless, forced by a public outcry, politicians in power are compelled to initiate a criminal investigation. Corporate governance reforms and enforcement efficacy are contingent on their independence and objectivity guaranteed and underwritten by the state if such prosecution is to have a just outcome. In the cases of corporate scandals reviewed in this study, the political-business nexus has severely compromised the powers of the regulatory agencies especially in their independence, transparency and impartiality. In Malaysia, the direct and indirect business involvement of the state and the major political parties, together with extensive crony capitalism, have surfaced a pervasive culture of corruption, exacerbated by executive interference in the regulatory institutions, compromising the latter's impartiality and objectivity; a considerable volume of evidence of these infractions has been offered in this thesis.

Thus, the efficacy of corporate governance reforms and enforcement is questionable given the hegemony of the executive arm of government over state institutions. Concerns persist over the independence of regulatory institutions when dealing with politically-connected companies about alleged violations. While regulatory institutions can and often behave independently when no major political or corporate interests are concerned, they have been efficient instruments to advance the vested interests of powerful politicians and businessmen.

Key appointments in the regulatory and enforcement agencies are solely within the executive's discretion, largely unquestioned by the state institutions that can check and balance excessive use, misuse or abuse of power. Such potent political influence on the corporate landscape enables regulatory capture by the executive branch and accounts for the diffuse substance of corporate governance in the country. For instance, locating the MACC under the Prime Minister's Department risks its subordination to political office and violates its credibility, integrity, independence and vigilance in investigations and prosecutions (Siddiquee, 2005). There are serious allegations that the MACC has been manipulated to act against individuals and parties threatening the status quo; it has been inordinately efficient against the opposition but, conversely, either reluctant or extraordinarily incompetent in cases where the ruling Barisan Nasional supporters are involved.

The findings in the four case studies clarify that the state is not objectively and lawfully seeking the prosecution of corporate misbehaviour. External and domestic investors remain unconvinced of the autonomy of the nation's regulatory institutions. A dual standard in enforcing corporate governance reforms is a major determinant of the persistence of corrupt business dealings despite corporate regulatory reforms. Strict enforcement of policies reaffirming the independence of the civil service bureaucracy and the regulatory agencies are wanting in Malaysia, primarily attributable to the entrenched political-business nexus. Corporate governance reforms, in other words, must be grounded on institutional reforms guaranteeing the separation of powers in the institutions of a democratic state.

#### **8.2.4.3 Weak State Institutions**

Common to the four corporate crime scandals is, therefore, the failure and distinct reluctance to address the institutional power structure flaws. The recurrence of corporate scandals, in spite of cyclical reforms, demands a radical structural transformation and re-balancing of state institutions to diminish, if not extinguish, the current centralized elite power model.

In Malaysia, the executive branch of government constitutes the omnipotent institution of the state. Currently, the implementation and enforcement of laws, rules, regulations and procedures that govern market and business operations is contingent on the will of the executive branch vested in the Prime Minister who concurrently is the Finance Minister, assigning to him political, financial and business patronage and selective interventions through regulatory agencies. The MACC reports to the Prime Minister's Office while the Finance Minister supervises such financial governance bodies as the Securities Commission, Bursa Malaysia and Bank Negara. Such convergence of executive power and patronage transcends the power of the legislative branch and subordinates parliament's role, including that of the Public Accounts Committee (PAC), in checking and penalising abuses of power or instituting legal action against well-connected business people and influential politicians.

This concentration of power raises key institutional and structural concerns about the effectiveness of democratic "check and balance" mechanisms. State or national governance enables the executive branch to direct regulatory attention to or away from preferred companies and individuals. Structural reforms of the institutions of state must ensure the devolution of power to regulatory institutions and strong legislative firewalls to ensure their autonomy. That this will ensue in Malaysia is extremely unlikely as the

Barisan Nasional retained power of the government after the 2013 General Election while its senior partner, UMNO, has shown no desire to reduce its hegemonic capacity to practice patronage and allocate rent-creating opportunities in a selective and non-transparent manner.

### **8.3 Organizational Deviance**

The blatant misbehaviour of individual and corporate deviants is invariably shaped by corporate policies and culture that foster such tendencies, raising the challenge of the optimal approach to manage corporate and individual transgressions. This thesis illustrates the failure of state-imposed reforms to remedy corporate misgovernance and criminal behaviour due to selective interference and intervention in the prosecution of deviant practices. Corporate self-regulation does not appear to be a viable option given the selective hands-off approach to enforcing corporate crime or a dilution of the will to pursue them when the judicial process is initiated.

### **8.4 Social Control**

Typical corporate crime consequences include the prosecution of individual offenders or the imposition of fines on the corporation. In the former, individuals must be held responsible and accountable for their decisions leading to white-collar crimes (Geis and DiMento, 1995) but protracted legal processes tend to dilute punitive sanctions. Furthermore, research has questioned the deterrent effect of the threat of external sanctions on corporate offenders (Makkai and Braithwaite, 1994). This individualistic focus also implies that individual offenders can be discovered, which is difficult in complex corporations.

Applying sanctions only to individual corporate officers ignores the organizational entity as a legal body in committing corporate crimes. Thus, the corporate entity must be held responsible and accountable for corporate deviance typically by the imposition of fines although such sanctions are largely ineffective (Mokhiber, 1988). Fines would have to be of an unrealistic magnitude to deter corporate greed for profits and the unlikely probability of detection (Coffee, 1981). Furthermore, a serially offending component should be severed from the organization (Walt and Laufer, 1992). Such conditions could require compliance with organizational restructuring to mitigate or eliminate an unethical or corrupt culture. Corporations could also be required to contribute all fraudulently obtained money into a fund to assist its victims (King et al., 2009) or public acknowledgement of offenses and admission of guilt in a media campaign. In particular, corporate funding of political parties and politicians must be done in a transparent manner, even publicized through the media, to ensure no favouritism during the award of public contracts.

Other sanctions, analogous to those for individual transgressions, deserve exploration (Walt and Laufer, 1992). Furthermore, instead of issuing fines or imposing lengthy sentences on individuals, probation and rehabilitation should be explored as punishment options. Probation would require increased scrutiny and observation of corporate activities to ensure compliance with laws and to mitigate harm (Walt and Laufer, 1992). Such rehabilitative actions absorb considerable resources to investigate complex corporate manipulative strategies and cast a negative shadow on such innocent parties as shareholders, consumers and employees (Geis and DiMento, 1995).

## **8.5 Limitation of Analytical Strategy**

The central objective of this study is to comprehend why corporate scandals continue to occur despite the introduction of reforms. This study has drawn out key themes among the identified corporate scandals, uncovering common patterns across the cases, and failures that have consistently weakened attempts to control corporate scandals. Sherman's (1978) model has provided powerful analytical insights in amplifying this issue.

There are, however, some limitations with the model. The first limitation relates the adaptation of Sherman's (1978) conceptual model to investigate public scandals. While Sherman's (1978) research dealt with scandals within a public entity (the police force), this study centres on corporate scandals involving firms with political connections. This study acknowledges that both entities are fundamentally different in nature and characteristics. While Sherman (1978) highlighted the progressive transformation of the police organization as a result of internal motivation to reform, this study argues that the core features of Malaysia's political economy model is the key deterrent for reform to take root. Through an analysis utilizing an adaption of Sherman's (1978) scandal and reform model, this study has exposed several vital commonalities relating to failures of corporate governance reforms in deterring corporate scandals following the AFC and provides insights into the major structural reforms that are required.

The second key challenge faced by this study was the synthesis of results from distinctly diverse corporate scandals through the application of its analytical strategy. Despite this challenge, the model has achieved the objective of understanding why corporate scandals continue to recur despite the initiation of governance reforms, mainly by focusing attention on the conduct and exercise of political power. This study has

drawn out the key themes in the case studies of corporate scandals, uncovering common patterns of governance failures, leading to the primary conclusion that what is required is a major devolution of power to key oversight agencies. This devolution of power would lead to checks and balances, thereby rendering the reforms substantively meaningful.

## **8.6 Recommendation for Future Research**

Further research into corporate scandals is necessary to improve the understanding of their complex nature. Significantly, scholarship and research focusing on corporate crime and scandals involving political elites is lacking in comparison to crimes committed by company executives (Snider, 2003). Greater and more focused scholarly attention should be given to corporate crime and scandals in both developed and emerging economies. Corporate scandals involving politically-connected companies deserve research and investigation especially those involving criminal and unethical practices involving the elite, in particular the role of the state, using the case study methodology. Particular consideration should be focused on the lack of institutional independence and the failure of reforms. This will continue to prove difficult, as corporations and government agencies tend to restrict the access that researchers have to such information (Berrington et al., 2003). Researchers have a duty to propose new and creative approaches to examine corporate philosophies, regulatory frameworks and the relationship between them. This effort would continue to increase the knowledge base exploring corporate and financial crimes to formulate viable policy solutions to these complex and recurring problems.

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