

## The Analysis of Limited South Asian Corporate Governance Standards after Financial Crisis-Cases in India and Malaysia

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### Abstract

*After the recent global crisis, corporate scandals and bankruptcy in US and Europe, there is some certain evidence on weak corporate governance, risk management and audit system. The 2009 India Code of Corporate Governance also revealed that during the crisis time, there are certain weaknesses although corporate structure is fairly durable. Hence, this paper chooses a different analytical approach and among its aims is to give some systematic opinions.*

*First, it classifies limited South Asian representative corporate governance (CG) standards into each group: India and Malaysia latest CG principles covered, so-called relative good CG group, while it uses ACCA and OECD and ICGN principles as reference. Second, it, through analysis, identifies differences and advantages between above set of standards which are and have been used as reference principles for many relevant organizations.*

*Third, it establishes a selected comparative set of standards for South Asian representative corporate governance system in accordance to international standards.*

*Last but not least, this paper covers some ideas and policy suggestions.*

**Keywords:** Corporate Governance Standards, Board Structure, Code Of Best Practice, Financial Crisis, Corporate Scandals, Market Manipulation, Internal Audit

### Introduction

After corporate scandals happening during and after global monetary and financial crises, it is necessary to re-evaluate code of corporate governance. In reality, many nations re-issue their principles of corporate governance as guidelines for their market and companies. This paper selects an easy-reading writing style, and it finds out that there is still some academic words need to be explained in further.

The organization of paper contents is organized as following. As our previous series of paper, Research literature and theories are covered in the first two sessions. Next, it followed by introduction of our research methodology in session 3 (3rd). Continuously, session four (4) covers our familiar four (4) groups of empirical findings. And our conclusion and policy suggestion is covered in the fifth (5th) session. Before last, there are exhibit session which covers some summary of this paper's analysis and comparison. And lastly, a glossary note is provided with information for reference and because of reducing repeating terminology.

### Body of Manuscript

#### Research Literature Review

There are many and controversial opinions on corporate governance theories and practices. For example, Jensen and Meckling presented their conceptual agency theory on the separation of ownership and management [1]. Thailand Code 2006 pointed that CG is the system of internal controls and procedures by which single companies are managed.

Besides, Indonesian 2006 Code of Good CG stated that good CG relates to the investor's confidence both in the companies as well as in the overall business environment and lead to sustainable economic growth and stability.

Additionally, OECD 2004 also issued a set of CG standards to help governments improve their legal, institutional and regulatory framework for CG in their countries. Moreover, the Basel Committee for Banking Supervision also confirmed banking supervision cannot function well if sound CG is not in place. And sound CG can contribute to a collaborative working relationship between bank management and bank supervisors.

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Because there are not many researches and surveys done in South Asian region on CG, next, what is the limited comparative standardized set of so-called comparative South Asian corporate governance standards?

## **Theory of Corporate Governance, Scandal And Market Manipulation**

### **Theory Of Manipulation**

Together with the development of financial and stock markets, there are some scandals with errors of market manipulation. They are errors in interfering the market operation and create false information on price or market for a financial commodity such as stock. Manipulation comes from either the market itself or from the company management, in some cases, we may call it insider trading.

### **Theory of Corporate Governance And Financial Crisis**

In 2008, OECD recommended to improve corporate areas in remuneration and risk management. OECD also stated that the financial crisis revealed severe shortcomings in corporate governance.

Also, Erkens et al found out that companies with more independent board and higher institutional ownership experienced worse stock returns during the crisis period [2]. Guota et al pointed that there is the lack of significant impact of corporate governance quality on performance. And well governed firms do not outperform poorly governed firms.

Hence, we can see, there exist various views on corporate governance and its importance.

### **Research Methodology**

Firstly, we analyze and compare corporate governance principles in each of two (2) different groups including: 1) Group – Limited South Asian CG representative standards including Indian Code 2009 and Malaysian Corporate Governance Principles.

We also use, but not limited to, international standards of corporate governance such as: ICGN and OECD Corporate Governance Principles and Enhancing Banking CG Code 1999 which have many modifications in corporate governance principles after the crisis period.

Then, we propose what so-called limited comparative South Asian corporate governance principles which are aiming to create a basic background for relevant corporations interesting in different aspects of corporate governance subjects and functions as the recommendation to relevant countries' government and other relevant organizations for public policy and necessary evaluation.

Last but not least, for a summary of our standards, see Exhibit and the below table 1 and 2 in relevant sessions.

### **Empirical Findings**

#### **Findings on Corporate Governance Issues after Financial Crisis, Corporate Scandals and Market Manipulation**

Certain popular issues including: the responsibility of the Board of Directors, both as a whole and as individual, to the mission of protecting and growing net value of total company asset.

Also, we can find out another corporate governance (CG) issue. It is, the lack of effective mechanism to avoid insider trading in buying and selling stock or shares of management. Another one is

the transparency mechanism still existing with errors that lead to declining company's credibility to investors.

### **Findings on Ways of Manipulation during Corporate Scandals**

Several Manipulation Techniques found out during corporate scandals involve, but not limited to:

#### **The Manipulation Techniques In The Income Statement**

In HealthSouth, the US largest owner of inpatient rehabilitative hospitals, corporate scandal, CEO is accused of manipulating the income or earning by making false report of fictitious transactions and accounts around the year 2006. Or in Worldcom scandal case, another falsification in expenditure management happened. The amount of \$3,8 b is indicated as capital expenditure, instead of recognized it as operating expense.

#### **The Manipulation Techniques in Both the Income Statement and Balance Sheet**

In the case of Global Crossing scandal around 2001, the company reported false profit figure of long term contracts at the initiation of the contract, instead of expanding over its life. Another example is Waste management scandal, a publicly traded waste management company, the management made false report of \$1.7 b in fake earnings.

#### **The Manipulation Techniques Relevant To International Accounting Practice Code**

In the scandal case of Global Crossing Ltd., a telecommunication firm, there is a failure in using international accounting standards (GAAP) in making financial reports. The company did not fairly present financial statements.

#### **Other Manipulation Techniques Net Belong To Above Classifications**

In some scandals, there is management manipulation which causes the loss of investments. For example, in Stanford financial scandal around the year 2009, investors lose profits when they trust their money was invested in CDs. In other cases, information on good business opportunities, which contains uncertainty and risks in future, or information on probability of winning auction of company can be an attribute to market price manipulation. Last but not least, insider trading matters are also appear in some corporate scandals.

#### **Actions on Preventing or Controlling Negative Manipulation**

Among necessary actions to control negative market manipulation are, but not limited to, the mechanism of internal control of the board aiming to increase communication and transparency with investors. Both internal control system and audit mechanism need to enhance to overcome failures in many scandals.

#### **Findings on Construction of Comparative International Corporate Governance Standards**

These findings will be shown in a detailed analysis of a model indicated in the later sessions.

<4.1> - Group – Limited South Asian Corporate Governance standards analysis

#### **The Indian Code of Governance 2009**

Among its advantages are, but not limited to, description roles of independent directors, for example, discussing impacts on minority

shareholders.

Additionally, it is good to state that the BD needs directors with qualification, positive attributes, independence and availability of time.

Generally speaking, The Code focuses on roles of audit partner. However, it would be better to add more information of a CFO or Finance Director. (See Exhibit 1).

## Exhibit

### Exhibit 1: The 2009 Indian Code of Corporate Governance (a short summary evaluation)

Subjects or parties	Main quality factors	Sub quality factors	Responsibilities	Objectives	Note
Audit committee	At least 3 members; monitor EA independence;	Chairman of AC has additional variable payment;	identify risks; process of risk identification, risk mitigation, risk optimization;	Not mentioned clearly in the code;	
Nomination committee	Majority of independent directors;	Including chairman; can have additional variable payment;	Processes to evaluate skills/knowledge/ experience/ effectiveness of individual directors and board; recommend appointment of ED;	Not mentioned clearly in the code;	
Compensation, Remuneration committee	Comprise at least 3 members; majority be NEDs;	Authority delegated by board;	Remuneration includes fixed and incentive; determine criteria of remuneration policy;	Not mentioned clearly in the code;	As understood from the Code;
CEO /President/MD	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Separated roles and offices;	Not mentioned clearly in the code;	
The Chair	Not mentioned clearly in the code;	Can have additional variable payment;	Separated roles and offices;	Not mentioned clearly in the code;	
CEO and The Chair relationship	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Clear demarcation of roles and responsibilities;	Promote balance of power;	
Corporate Secretary	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Compliance officer	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Board of Directors	Not mentioned clearly in the code;	Given substantial time to contribute effectively to board discussion;	Actions directors should not do included in formal appointment letters; identify risks;	Ensure compliance of all laws applicable to firm;	As understood from the Code;
Executive/ Representative director	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Formal appointment letters;	Not mentioned clearly in the code;	
Non-executive director	Fixed and variable payment;	Firm has option to pay Fixed contractual remuneration, not linked to profits, to NED;	Formal appointment letters by firm;	Not mentioned clearly in the code;	
Independent director	Experience, Able to read and understand F.S; certificate of independence;	Foresight, integrity, expertise, managerial qualities; term <=6 yrs;	Formal appointment letters by firm;	Not mentioned clearly in the code;	
CFO	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	

Management team (Senior Administration)	Not mentioned clearly in the code;	Structure of pay for senior mgt monitored by remuneration committee;	Independent directors have option and Freedom to interact with MGT;	Independent directors perform functions effectively;	
Supervisory for the board	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Professional advice from external source;	Not mentioned clearly in the code;	
Supervisory for the managers	Not mentioned clearly in the code;	Can be auditors;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	As understood from the code;
Internal control	Not mentioned clearly in the code;	IC reviewed by AC;	Board review the effectiveness of IC, including financial, operational, compliance, RM;	Not mentioned clearly in the code;	
Internal or statutory audit	Board appoint internal auditor who should not be an employee;	IA reviewed by AC;	AC have facility to separate discussion with IA and EA and MGT;	Not mentioned clearly in the code;	As understood from the code;
External audit	Discuss annual work program with AC;	AC recommend appointment and removal of EA;	AC have facility to separate discussion with IA and EA and MGT;	Not mentioned clearly in the code;	
Disclosure and transparency	Remuneration policy for board disclosed;	Independent directors have access to extra information;	Guidelines followed by nomination committee disclosed in annual report;	Not mentioned clearly in the code;	
Shareholders and Minority Stockholder	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Board meeting agenda has analysis of impacts on minority shareholders;	Not mentioned clearly in the code;	
Accountability	Not mentioned clearly in the code;	Proper and accountable audit;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Leadership	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Act by CEO or chairman;	Not mentioned clearly in the code;	As understood from the code;
Employee	Not mentioned clearly in the code;	Mechanism for report of violation of code of conduct;	COE included in formal appointment letters to NED;	Not mentioned clearly in the code;	
3 <sup>rd</sup> parties and conflicts of interests	Not mentioned clearly in the code;	Not mentioned clearly in the code;	AC monitor /approve all related parties transactions;	Not mentioned clearly in the code;	
Code of ethics (conduct)	Not mentioned clearly in the code;	Report unethical behavior;	Included in formal appointment letters to NED;	Not mentioned clearly in the code;	
Group and subsidiaries	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
CG Code itself	A benchmark for corporate sector; Sound and efficient; fairness;	transparency; accountability; responsibility;	Not mentioned clearly in the code;	Long term value for shareholders and stakeholders;	
Management system	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
<b>Note</b>	The underlined part is describing some more works needed to be done for relevant subjects and parties.				

**Exhibit 2: The 2012 Malaysian Code of Governance (a short summary evaluation)**

Subjects or parties	Main quality factors	Sub quality factors	Responsibilities	Objectives	Note
Audit committee	Not mentioned clearly in the code;	Procedures to assess suitability and independence of EA;	Ensure F.S comply with applicable financial reporting standards;	Not mentioned clearly in the code;	
Nomination committee	Chaired by independent director;	Comprise of independent NED;	Maintain and review criteria in recruitment process; oversee the selection and assessment of directors; recommend director candidates;	Not mentioned clearly in the code;	
Compensation, Remuneration committee	Not mentioned clearly in the code;	Not mentioned clearly in the code;	BD set formal and transparent remuneration policies;	Retain directors;	
CEO /President/MD	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Develop with BD corporate objectives/ functions;	Not mentioned clearly in the code;	
The Chair	Can be independent director;	Chairman of board not be independent director;	Should be non-executive member of the board; Lead the BD overseeing MGT;	Not mentioned clearly in the code;	
CEO and The Chair relationship	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Should be held by different people;	Not mentioned clearly in the code;	
Corporate Secretary	Raise skills and professional standards;	Suitably qualified and competent;	Procedural and regulatory requirements consulted by BD;	Not mentioned clearly in the code;	
Compliance officer	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Compliance function acted by board;	Not mentioned clearly in the code;	
Board of Directors	Members have access to appropriate continuing education;	Comprise of independent directors;	Clear functions, roles and responsibilities; allow members to access information and advice; build a board charter;	Company's strategies promote sustainability;	As understood from the Code;
Executive/ Representative director	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Non-executive director	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Independent director	Term not > 9 years;	Objective judgement;	BD take assessment of independent directors annually;	Not mentioned clearly in the code;	
CFO	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Management team (Senior Administration)	Give Feedback on internal disclosure policy;	Functions delegated by BD; supply accurate and complete information to BD;	Mindful of their duty to direct efforts and resources; MGT proposals reviewed, challenged and approved by BD; implement strategic plan monitored by BD;	Toward the best interests of firm and shareholders	
Supervisory for the board	Legal, financial governance advice;	Independent professional advice;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	

Supervisory for the managers	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Act by board;	Not mentioned clearly in the code;	As understood from the code;
Internal control	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Important for RM; BD review IC;	Not mentioned clearly in the code;	
Internal or statutory audit	Not mentioned clearly in the code;	Head of IA with relevant qualifications;	Head of IA report to AC; appraisals of IC, RM;	Not mentioned clearly in the code;	As understood from the code;
External audit	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Its suitability and independence assessed, monitored by AC;	Not mentioned clearly in the code;	
Disclosure and transparency	Disclose main features of RM framework and IC system;	Timely availability of quality and accurate information;	Appropriate disclosure policy ensured by BD; leverage on IT for effective dissemination of information;	Not mentioned clearly in the code;	
Shareholders and Minority Stockholder	Encourage poll voting;	Effective communication b.t BD and shareholders;	Encourage participation at meeting; proactive engagement with board;	Not mentioned clearly in the code;	
Accountability	Remuneration reflect accountability and contribution of directors;	Not mentioned clearly in the code;	CG as processes and procedures used to direct and manage the business toward enhancing accountability;	Not mentioned clearly in the code;	
Leadership	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Acts by Board; clear roles;	Not mentioned clearly in the code;	As understood from the code;
Employee	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
3 <sup>rd</sup> parties and conflicts of interests	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Code of ethics (conduct)	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Formalize ethical standards;	Not mentioned clearly in the code;	
Group and subsidiaries	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
CG Code itself	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Focus on substance more than form;	Not mentioned clearly in the code;	
Management system	Transparent, efficient, able to be audited;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	Not mentioned clearly in the code;	
Note	The underlined part is describing some more works needed to be done for relevant subjects and parties.				

### The Malaysian Corporate Governance Principles

The Malaysian Code of CG 2012 has been modified since its first version in 2000 and 2nd version in 2007.

One of its distinctions is clarifying board structure and mentioning a culture of corporate governance. And it also pointed the role of the Board in establishing a sound framework to manage risks.

Besides, the Malaysian Code has advantages in encouraging senior MGT to have constructive engagements with shareholders. For more information, please see Exhibit 2. However, it would be better to mention roles of compliance officer.

### Comparison between the Indian and Malaysian Corporate Governance Principles

A lot of information on auditor and audit partner are provided in the Indian code. Also, it makes a sound point when it mentions the role of managing director of a public company as independent director in other firms should be restricted to seven (i.e., the number of other companies). But it would be better to give a clearer description on corporate secretary. (See Exhibit 1).

On the other hand, the Malaysian Code stated the firm needs to have a Board charter mentioning the division of responsibilities and powers b.t the board and MGT, as well as processes for board meeting. Besides, it also describes roles of corporate secretary.

**Table 1: A so-called Limited South Asian CG representative standards**

Subjects or parties	Main quality factors	Sub quality factors
Audit committee	At least 3 members; regard to audit partners' qualification, strength and weakness;	Procedures to assess suitability and independence of EA;
CEO and The Chair	Separated roles and offices;	Should be held by different people;
Corporate Secretary	Suitably qualified and competent;	Procedural and regulatory requirements consulted by BD;
Compliance officer	Compliance function acted by board;	N/A (for further research and implementation)
Board of Directors	Establish IA functions which directly report to AC; devote sufficient time;	Oversee the performance of MGT; ensure candidates appointed to senior MGT are of sufficient calibre;
Independent director	Foresight, integrity, expertise, managerial qualities; term <=6 yrs;	Independent and Objective judgement;
Supervisory board to the Management	Act by Board;	Can be auditors;
Supervisory to the Board of Directors	Independent professional advice;	Independent professional advice;
Internal control	Board review the effectiveness of IC, including financial, operational, compliance, RM;	Sound framework of reporting on IC;
Internal audit	Board appoint internal auditor who should not be an employee;	Head of IA report to AC; appraisals of IC, RM;
External audit	AC have facility to separate discussion with IA and EA and MGT;	Discuss annual work program with AC;
Disclosure and transparency	Internal disclosure policy; disclose related parties transactions;	Publish board charter on company website;
Shareholders	Encourage participation at meeting; proactive engagement with board;	Board meeting agenda has analysis of impacts on minority shareholders;
The corporation as a whole entity	Place certificate of independence of independent directors on firm website;	Its risk level tolerance determined by board;

### Conclusion

To overcome weaknesses from CG during crises, The Indian Code suggested many innovative ideas including but not limited to clarification of auditor (see Exhibit 1).

Besides, the Malaysian Code included guidelines on obligations of management in enterprises. Above comparative analysis of Limited Comparative South Asian CG Code shows us a strong focus on enhancing roles of not only BD members but also managers and other stakeholders, which are vital participants in retaining and developing a sustainable profit business [3-13].

Past surveys from McKinsey in 2000 showed results such as investors willing pay 24% premium for good CG in South Korea and 18% premium for that in UK (see Exhibit 3).

### Exhibit 3 – Survey of Importance in Corporate Governance

(Source: McKinsey Survey, 1999-2000)



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In consideration of corporate governance issues analyzed in the previous sessions, we proposed the main and sub quality factors in this paper **a set of general comparative South Asian corporate governance standards** in a limited model with selected countries. Though limited, it has some implications for further research and proper recommendations to relevant government and organizations. And it also provides relevant academic and non-academic, lawyer and consultant, board and non-board people with minimum information for further researches.

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