Singapore Journal of Legal Studies
[2013] 100–124

THE EVOLUTION OF MALAYSIAN SHAREHOLDER PROTECTION: A LEGAL ORIGINS ANALYSIS

VIVIEN J.H. **CHEN***

In the aftermath following the Asian financial crisis, the World Bank prescribed regulatory reforms as a remedy for weak financial fundamentals. These reforms reflect the claims of the strong form legal origins hypothesis that countries with common law legal traditions have stronger investor protection laws and better financial outcomes than countries of civil law origin. This paper seeks to test the legal origins hypothesis through an examination of the evolution of Malaysian shareholder protection from 1965 to 2010. Comparison with six other countries in the time series studies indicates that Malaysia had the highest growth in formal shareholder protection. Persistent borrowing from the regulations of other common law countries suggests that inherited legal tradition has, to an extent, influenced the evolution of Malaysian shareholder protection. The influence of other common law countries' regulations is explained by institutional complementarities, supporting the claims of the weak form legal origins hypothesis.

I. INTRODUCTION

In the wake of the Asian financial crisis, the World Bank asserted that poor corporate governance in the affected countries was among the primary causes of the financial crisis.[1] Together with other transnational financial organisations, they attributed the prevalence of cronyism and corruption to the lack of regulatory safeguards.[2] They put forward the Anglo-American regulatory framework as the model to which East Asian countries should aspire. Malaysia's failure to conform to these prescriptions precipitated a loss of investor confidence and the withdrawal of foreign

* Fellow in the Department of Business Law and Taxation, Faculty of Business and Economics, Monash University, Australia. I would like to thank Dr. Michelle Welsh and Professor Richard Mitchell for their invaluable support and comments on this paper. I am also grateful to Professor Aiman Nariman of Ahmad Ibrahim Kulliyyah of Laws, International Islamic University Malaysia for her comments on an earlier draft of this paper. All errors and omissions remain my sole responsibility.

1 World Bank, *East Asia: The Road to Recovery* (1998), online: World Bank <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1998/11/17/000178830_98111703550666/Rendered/PDF/multi_page.pdf>.

2 Virginita Capulong *et al.*, eds., *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand*, vol. 1 (Manila: Asian Development Bank, 2000).

investment.[3] Following this, steps were taken to reform the Malaysian corporate governance regulatory framework.[4]

The prescriptions of the World Bank are underpinned by the legal origins hypothesis which asserts that common law investor protection leads to stronger financial outcomes.[5] These policies have maintained their influence through annual country rankings on the 'Doing Business' index. Although the policies have had a significant influence on regulatory reform, their theoretical basis has increasingly been discredited in recent years. Subsequent empirical testing of the legal origins thesis has cast doubt on the veracity of its claims. The empirical methods underpinning the legal origins thesis have been shown to be lacking in rigour and the thesis premised on questionable assumptions. An alternative hypothesis on the effect of legal tradition has since emerged. This 'weak form' legal origins hypothesis concedes that the evolution of shareholder protection may also be affected by influences apart from legal origins. These include political and economic influences, and forces towards transnational harmonisation.[6] In contrast with the 'strong form' hypothesis which underpins the World Bank's prescriptions, the weak form hypothesis takes a neutral stance on the economic benefits of legal origins.

This paper seeks to contribute to the understanding of how legal origin influences the evolution of shareholder protection. It examines the nature and extent of changes in Malaysian shareholder protection from 1965 to 2010. This analysis adopts the quantitative measurement of law known as 'leximetrics'.[7] The leximetric method has been used to compare the strength of law across countries of different legal origins. This paper places the evolution of Malaysian shareholder protection in an international context through a comparison with data on shareholder protection in Australia, France, Germany, India, the UK and the US.

This study examines the mechanisms by which the English common law heritage has influenced the development of Malaysian shareholder protection. It tests the strong form and weak form legal origins hypotheses in the Malaysian context. The legal origins hypotheses are premised on the transplantation of Western legal systems. Nevertheless, their scholarship has paid little attention to the context in which these systems have been transplanted. This study underscores the need for recognition that the values embodied by transplanted law may at times lack compatibility with domestic norms. It highlights the anomalous consequences which have ensued from such lack of compatibility in the Malaysian context.

---

3 Pik Kun Liew, "The (Perceived) Roles of Corporate Governance Reforms in Malaysia: The Views of Corporate Practitioners" in Mathew Tsamenyi & Shahzad Uddin, eds., *Research in Accounting in Emerging Economies*, vol. 8 (United Kingdom: Emerald Group Publishing Limited, 2008) 455 [Liew, "Perceived Roles"].

4 Malaysia, Finance Committee on Corporate Governance, *Report on Corporate Governance* (February 1999).

5 Doing Business, Methodology for Doing Business, online: Doing Business <http://www.doingbusiness.org/methodology>.

6 John Armour *et al.*, "How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection" (2009) 57 Am. J. Comp. L. 579 [Armour *et al.*, "How Do Legal Rules Evolve?"].

7 Priya P. Lele & Mathias M. Siems, "Shareholder Protection: A Leximetric Approach" (2007) 7 J. Corp. L. Stud. 17.

In summary, the findings of this study indicate that the weak form of legal origins has stronger explanatory power for the evolution of Malaysian shareholder protection. Institutional complementarities account for the persistent borrowing from within the common law tradition. The trajectory of growth in Malaysian shareholder protection was characterised by short periods of rapid growth interspersed between longer periods of relative stability. In comparison with the six other countries, Malaysia had the weakest shareholder protection at the start of the period but experienced the highest level of growth over the period of the study. Despite strong growth in formal shareholder protection, anecdotal evidence suggests that Malaysian regulation lacks substantive effect. The analysis of Malaysian shareholder protection underscores the limitations of the legal origins thesis in its focus on formal law with minimal consideration of implementation in its specific context.

Part II of this paper canvasses the legal origins theory. The methodology used in the early legal origins literature and more recent developments will be examined in Part III. In Part IV, the results of the leximetric study of Malaysian shareholder protection from 1965 to 2010 will be discussed. These results will be compared with six other countries in Part V. Part VI discusses the key findings of this study. Part VII concludes.

II. Legal Origins Theory

The legal origins hypothesis posits that differences in regulatory style among legal traditions have a strong influence on the quality of countries' laws.[8] Differences between common law and civil law traditions are the main focus of the legal origins theory, with civil law being further divided into French, German, Scandinavian and socialist origins. Legal origins have been defined broadly as the "style of social control of economic life".[9] La Porta and his colleagues argue that the distinguishing characteristics of the common law's regulatory style lie in its emphasis on private solutions and judicial independence. These characteristics are thought to facilitate the protection of private property from expropriation by the state. La Porta *et al.* assert that there is a tendency in civil law systems towards extensive government ownership and regulation. In contrast with the common law's focus on dispute resolution, civil law systems are centred on policy implementation.[10]

The differences in regulatory style are posited to affect the quality of investor protection which in turn influences financial outcomes. La Porta *et al.*'s empirical studies indicated that English common law countries had stronger shareholder protection and better financial outcomes than French civil law countries.[11] Proponents

---

8 Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "The Economic Consequences of Legal Origins" (2008) 46 Journal of Economic Literature 285 at 323 [La Porta, Lopez-de-Silanes & Shleifer, "Economic Consequences"].

9 *Ibid*. at 286.

10 Djankov *et al.* argue that while all legal systems seek to address the problems of state abuse and market failure, French civil law is more concerned with market failure and less with state abuse, while common law is the converse: Simeon Djankov *et al.*, "The New Comparative Economics" (2003) 31 Journal of Comparative Economics 595; Edward Glaeser & Andrei Shleifer, "Legal Origins" (2002) 117 The Quarterly Journal of Economics 1193.

11 Rafael La Porta *et al.*, "Legal Determinants of External Finance" (1997) 52 The Journal of Finance 1131 [La Porta *et al.*, "Legal Determinants of External Finance"]. The range of financial outcomes examined

of the strong form legal origins theory maintain that legal origins exert a persistent and powerful influence over the infrastructure of countries' legal systems. Fundamental differences in legal origins are thought to persist over centuries. This path dependence is attributed to the incorporation of distinctive institutions, beliefs and ideologies into the legal and political infrastructure.[12] The strong form hypothesis posits that legal origin is exogenous, time-invariant and exerts a powerful influence over economic outcomes.[13]

Several channels through which legal origins exert an influence on law and financial outcomes have been identified in the literature. The 'adaptability channel' asserts that judicial decision-making on a case-by-case basis in common law systems facilitates adaptation to changing circumstances.[14] Civil law, on the other hand, is alleged to be more rigid due to its reliance on codes which are less amenable to change. The 'judicial channel' posits that the common law's value of judicial independence provides better security for private property rights from expropriation by the state.[15]

According to the 'weak form' legal origins hypothesis, borrowing from the regulations of parent countries is facilitated by the "affinities of legal thought and language".[16] As countries within the same legal family often have similar institutions, the cost of adopting regulations from these countries is lower. This promotes path dependence in accordance with legal traditions.[17] The strength of the legal origins effect based on institutional complementarities may be weak compared to other forces such as convergence towards international standards.[18] Armour *et al.* assert that the weak form of legal origins is not an important determinant of economic outcomes.[19] The interconnection of legal institutions with other social institutions suggests that legal systems are to an extent endogenous to their economic and political contexts.[20]

The spread of legal families across the world was brought about by the transplantation of legal systems through colonisation or voluntary adoption. Malaysia inherited its common law system through colonisation by the British. Scholars who examined the effects of transplantation found differences between the operation of transplanted legal systems and their parent systems.[21] Pistor *et al.*'s comparison of the evolution of corporate law since the beginning of the 19th century in four leading market economies and six transplant countries, including Malaysia, suggested

---

included stock market capitalisation, dividend payments, corporate valuations and the dispersion of corporate ownership: Rafael La Porta *et al.*, "Agency Problems and Dividend Policies Around the World" (2000) 55 The Journal of Finance 1.

12 La Porta, Lopez-de-Silanes & Shleifer, "Economic Consequences", *supra* note 8.

13 Aron Balas *et al.*, "The Divergence of Legal Procedures" (2009) 1 American Economic Journal: Economic Policy 138.

14 Thorsten Beck, Asli Demirgüç-Kunt & Ross Levine, "Law and Finance: Why Does Legal Origin Matter?" (2003) 31 Journal of Comparative Economics 653.

15 *Ibid.*

16 Armour *et al.*, "How Do Legal Rules Evolve?", *supra* note 6 at 598.

17 Juan C. Botero *et al.*, "The Regulation of Labour" (2004) 119 The Quarterly Journal of Economics 1339.

18 John Armour *et al.*, "Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis" (2009) 6 J. Empirical Legal Stud. 343 [Armour *et al.*, "Shareholder Protection and Stock Market Development"].

19 *Ibid.*

20 *Ibid.*

21 Djankov *et al.*, *supra* note 10.

distinct patterns in the evolution of corporate law in transplant countries which were not present in origin countries.[22] A lack of legal change or 'lethargy' during the first few decades of substantial socioeconomic change was particularly marked in common law transplant countries.[23] Pistor *et al.* also found that although transplanted countries continued to draw from the regulations of the leading countries of their legal tradition, they did not always adopt the norms embodied in the rules.[24]

The strong form legal origins thesis which has underpinned the World Bank's policies on regulatory reform for developing economies has been subjected to substantial scholarly critique. Studies have found that the patterns across legal families suggested by La Porta *et al.* were not present early in the 20th century. Musacchio found that the shareholder rights in countries of various legal origins converged in 1900 and 1913.[25] Likewise, claims of the common law's superiority in producing better law and, hence, economic development have been disputed. Serpoul argued that at the beginning of the 20th century, investor protection in France was better than in Britain.[26] Rajan and Zingales suggested that in 1913, France's stock market capitalisation was almost twice that of the US.[27] Garoupa and Liguere's study highlighted various examples of French law which produced more efficient outcomes than English law.[28]

Criticisms have also been made of the assumptions and methods underpinning the strong form legal origins thesis. Aguilera and Williams observed that the measure of economic success in the law and finance literature was biased towards free-market economies. When other measures of economic health such as poverty rates or employment rates were considered, social welfare states emerged as better performers than free-market states.[29] The strong form legal origins theory views the interventionist state as being negatively correlated with economic outcomes. It neglects to consider the role of the corporatist state commonly found in East Asia. These states take an active stance in economic development, both in terms of policy and the ownership and control of state-owned enterprises.[30]

---

22 Katharina Pistor *et al.*, "The Evolution of Corporate Law: A Cross-Country Comparison" (2002) 23 U. Pa. J. Int'l Econ. L. 791.

23 *Ibid.*

24 Katharina Pistor, "Rethinking the 'Law and Finance' Paradigm" (2009) B.Y.U.L. Rev. 1647 at 1654.

25 Aldo Musacchio, "Do Legal Origins Have Persistent Effects Over Time? A Look at Law and Finance Around the World c. 1900" (2007) Harvard Business School Working Paper 08-030, online: Harvard Business School <http://www.hbs.edu/faculty/Pages/download.aspx?name=08-030.pdf>.

26 Frederic Serpoul, "Shareholder Protection and Stock Market Development in France (1852-2007)" (2009) Saïd Business School Working Paper, online: Social Science Research Network <http://ssrn.com/abstract=1529271>.

27 Raghuram G. Rajan & Luigi Zingales, "The Great Reversals: The Politics of Financial Development in the Twentieth Century" (2003) 69 Journal of Financial Economics 5.

28 Nuno Garoupa & Carlos Gomez Liguerre, "The Syndrome of the Efficiency of the Common Law" (2011) 29 B.U. Int'l L.J. 287.

29 Ruth V. Aguilera & Cynthia A. Williams, "'Law and Finance': Inaccurate, Incomplete and Important" (2009) B.Y.U.L. Rev. 1413.

30 Katharina Pistor & Philip A. Wellons, *The Role of Law and Legal Institutions in Asian Economic Development 1960-1995* (Oxford: Oxford University Press, 1999); Kanishka Jayasuriya, "Corporatism and Judicial Independence within Statist Legal Institutions in East Asia" in Kanishka Jayasuriya, ed., *Law, Capitalism and Power in Asia: The Rule of Law and Legal Institutions* (London: Routledge, 1999) 147; Daniel D. Sokol, "Competition Policy and Comparative Corporate Governance of State-Owned Enterprises" (2009) B.Y.U.L. Rev. 1713.

One of the greatest challenges to the strong form hypothesis is the economic success of Northeast Asian civil law countries despite their non-conformity with this hypothesis.[31] While there was formal shareholder protection in these countries, the lack of enforcement resulted in poor minority shareholder protection.[32] The legal origins theory is premised on capital markets as a means of achieving economic development. It assumes that dispersed share ownership and strong shareholder protection are hallmarks of progressive and successful economies. In contrast, corporate governance in Northeast Asia was characterised by informal networks, dominant controlling shareholders and reliance on bank finance rather than capital markets.[33] Nee and Opper note the prevalence in East Asia of family-owned corporations with close ties with the state.[34] Although corporations played a central role in facilitating economic growth in South Korea, Taiwan and Japan, Northeast Asian economic success and their institutions are absent from discussions in the legal origins literature.[35]

III. Methodology

The legal origins theory is premised on the quantitative measurement of law known as the 'leximetric' method.[36] In the early law and finance literature, six variables relating to shareholder protection against expropriation by directors were examined in what was known as the 'anti-director rights' index.[37] These protections were the right to vote by proxy, cumulative voting, pre-emptive rights and the deposit of shares prior to general meetings. The variables also involved remedies for oppressed minority shareholders and the percentage of share capital needed to call an extraordinary general meeting.[38] Where threshold requirements were met, the score of 1 was given for each of the variables, and the score of 0 was otherwise given. Several of

---

31 John Ohnesorge, "Legal Origins and the Tasks of Corporate Law in Economic Development: A Preliminary Exploration" (2009) B.Y.U.L. Rev. 1619.

32 Likewise, Pistor and Wellons' analysis of law and economic development in Asia found that formal law had a minimal effect on corporate governance, particularly among state-owned enterprises: Pistor & Wellons, *supra* note 30; Marianna Belloc & Ugo Pagano, "Co-Evolution of Politics and Corporate Governance" (2009) 29 Int'l Rev. L. & Econ. 106.

33 Ohnesorge, *supra* note 31.

34 Victor Nee & Sonja Opper, "Bureaucracy and Financial Markets" (2009) 62 Kyklos 293.

35 Ohnesorge, *supra* note 31; Curtis J Milhaupt, "Beyond Legal Origin: Rethinking Law's Relationship to the Economy—Implications for Policy" (2009) 57 Am. J. Comp. L. 831. Likewise, Puchniak finds evidence contrary to the strong form legal origins thesis in his examination of the derivative action in Asia's leading economies. Shareholder protection through the derivative action was stronger in civil law countries than in common law countries. While judicial decisions accounted for the development of the derivative action in civil law countries, their common law counterparts relied on statute: Dan W. Puchniak, "The Derivative Action in Asia: A Complex Reality" (2012) 9 Berkeley Bus. L.J. 1.

36 Lele & Siems, *supra* note 7.

37 Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "What Works in Securities Laws?" (2006) 61 The Journal of Finance 1 [La Porta, Lopez-de-Silanes & Shleifer, "What Works in Securities Laws?"]; La Porta *et al.*, "Legal Determinants of External Finance", *supra* note 11.

38 Some studies had five instead of six variables in the anti-directors rights index, omitting the variable on pre-emptive rights. An additional variable in which countries which adhered to the 'one-share-one-vote' principle were given the score of 1 was included in some of the empirical studies: see for instance La Porta *et al.*, "Legal Determinants of External Finance", *ibid*.

the empirical studies analysed the laws of 49 countries from English common law, French, German and Scandinavian civil law traditions.[39]

The method used in the law and finance literature has also been described as numerical comparative law.[40] One of the main advantages of this method is its ability to facilitate the comparison of large amounts of information which would otherwise be overwhelming. According to Spamann, this method is particularly suited to testing theories which are thought to be applicable to a large number of countries.[41] The most common use of this method in the literature has been the comparison of law across countries with the objective of ascertaining whether there are differences among legal families. The leximetric method also reveals changes in the protective strength of regulations over time, facilitating an analysis of trends in legal development.

The leximetric approach is reductionist, giving rise to several limitations. First, reducing legal rights to a numerical value involves subjective judgement. Anderson *et al.* suggest that the effect of this may be ameliorated to an extent by subjecting the coding to the scrutiny of several people who are familiar with the law involved.[42] Secondly, the method fails to capture the wider context, including non-legal constraints and difficulties in enforcement.[43] Thirdly, the leximetric method assumes that each variable is of equal weight. It does not take into account the greater influence some laws may have in protecting shareholders from expropriation in practice. A country-by-country weighting of variables, however, has been argued as unduly subjective.[44] In recognising the limitations of this method, Spamann suggests that the research design for quantitative methods should be aimed at detecting interesting connections rather than descriptive accuracy.[45]

Scholars have also questioned the accuracy of La Porta *et al.*'s empirical findings. Their criticisms have centred on coding errors, the selection of variables, reliance on law in the books and cross-sectional data.[46] The Cambridge group sought to address some of the criticisms levelled against the methods underpinning the legal origins thesis by developing longitudinal studies of shareholder protection.[47] They sought to select variables which were representative of a range of legal traditions and crucial

---

[39] La Porta, Lopez-de-Silanes & Shleifer, "What Works in Securities Laws?", *supra* note 37; La Porta *et al.*, "Legal Determinants of External Finance", *ibid*. The range of countries examined in La Porta *et al.*'s empirical studies differed from study to study. For example, 27 countries were examined in Rafael La Porta *et al.*, "Investor Protection and Corporate Valuation" (2002) 57 The Journal of Finance 1147 and 71 countries were compared in Rafael La Porta *et al.*, "Judicial Checks and Balances" (2004) 112 Journal of Political Economy 445. Djankov and his colleagues examined 129 countries in Simeon Djankov, Caralee McLiesh & Andrei Shleifer, "Private Credit in 129 Countries" (2007) 84 Journal of Financial Economics 299.

[40] Holger Spamann, "Large-Sample, Quantitative Research Designs for Comparative Law?" (2009) 57 Am. J. Comp. L. 797 [Spamann, "Large Sample"].

[41] *Ibid.*

[42] Helen Anderson *et al.*, "Shareholder and Creditor Protection in Australia: A Leximetric Analysis" (2012) 30 Company and Securities Law Journal 360 [Anderson *et al*., "Shareholder"].

[43] Helen Anderson, *et al.*, "The Evolution of Shareholder and Creditor Protection in Australia: An International Comparison" (2012) 61 I.C.L.Q. 171.

[44] Armour *et al.*, "Shareholder Protection and Stock Market Development", *supra* note 18 at 607.

[45] Spamann, "Large Sample", *supra* note 40.

[46] Lele & Siems, *supra* note 7; Holger Spamann, "The 'Antidirector Rights Index' Revisited" (2010) 23 The Review of Financial Studies 467; Aguilera & Williams, *supra* note 29.

[47] Lele & Siems, *ibid*.

concerns in developing countries. Functional equivalents, stock exchange rules, default rules, corporate governance and takeovers codes were taken into account. The values given for variables included intermediate values between 0 and 1 to allow varying degrees of shareholder protection to be considered. The data sets have been made publicly available by the authors to enable scrutiny of their studies.

The first shareholder protection index examined 60 variables in France, Germany, India, the UK and the US from 1970 to 2005.[48] Anderson *et al.* subsequently added Australian data on shareholder and creditor protection from 1970 to 2010 to the time series studies.[49] There were 42 variables on shareholder protection against expropriation by the board and 18 variables relating to protection against other shareholders. The results of the 35-year study refute La Porta *et al.*'s claim that legal origins determine the strength of a country's shareholder protection. First, shareholder protection in common law countries was not stronger than civil law countries. Secondly, there were no distinct time-invariant differences between legal origins. All six countries had an overall increase in shareholder protection, with the US having the lowest shareholder protection at the end of the period.

The Cambridge group produced a second data set which covered the period 1995 to 2005 and examined ten variables on shareholder protection in 20 countries. Although shareholder protection was stronger in common law countries, it increased at a faster rate in civil law countries. The findings reflected a trend towards convergence across legal traditions.[50]

This paper draws from the study by Anderson *et al.* on the evolution of Australian shareholder protection between 1970 and 2010[51] and the comparative analysis of shareholder protection in France, Germany, India, the UK and the US over the 35-year period.[52] The methodology used by the Cambridge group and Anderson *et al.* is adopted in this study. The analysis of Malaysian shareholder protection covers a period of 45 years from 1965 to 2010 and examines 60 variables. 1965 was the year in which the first Malaysian companies legislation was enacted following independence from the British. Prior to 1965, shareholder protection had been regulated by companies legislation enacted during the colonial period, English common law and equitable principles.[53]

IV. Results

A. *Shareholder Protection Against the Board of Directors*

The sub-index in Figure 1 shows the growth in Malaysian shareholder protection against expropriation by directors between 1965 and 2010. The horizontal axis indicates the progression over time from 1965 to 2010, while the level of Malaysian shareholder protection against directors is indicated by reference to the vertical axis.

---

48 *Ibid.*

49 Anderson *et al.*, "Shareholder", *supra* note 42.

50 Mathias M. Siems, "Shareholder Protection Around the World (Leximetric II)" (2008) 33 Del. J. Corp. L. 111.

51 Anderson *et al.*, "Shareholder", *supra* note 42.

52 Lele & Siems, *supra* note 7; Siems, *supra* note 50.

53 Section 3 of the *Civil Law Act 1956* (Act 67, Malaysia) provided that English common law and rules of equity applied in Malaysia as long as they did not conflict with any written law.

This sub-index measures the growth in the protection of shareholders against expropriation by directors or managers against 42 variables.[54] Hence, the values in the vertical axis are considered against a possible maximum score of 42. These variables cover the powers of the general meeting in relation to capital measures, mergers, amendments of the articles of association, the sale of substantial assets, the election of directors and dividend distribution. Issues of self-dealing by directors, directors' remuneration and duties, the composition of the board and the disqualification of directors are also considered. Shareholders' rights to information, proxy voting, the requisition of general meetings and agenda setting are examined in the variables. Other issues examined in the variables include pre-emptive rights and the enforcement of shareholder protection and corporate governance codes.

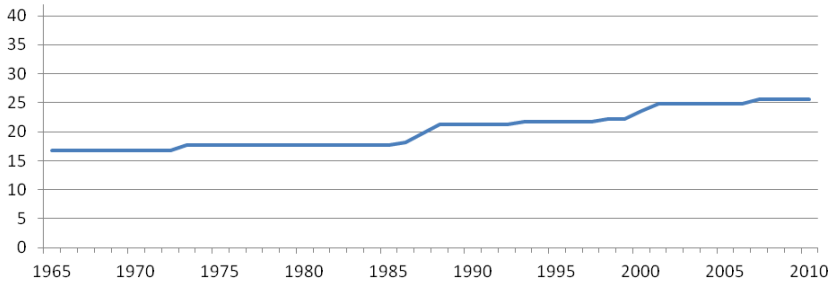

Figure 1. Shareholder protection against the board of directors (42 variables) in Malaysia from 1965-2010.

From 1965 to 1972 shareholder protection was stable and moderately low, at approximately 17 out of a possible maximum of 42. The *Companies Act 1965* gave the general meeting power over amendments to the articles of association and arrangements between the company and its creditors.[55] Shareholders also had the right to decide on capital measures including the reduction, increase, division or consolidation of share capital. The right to demand an extraordinary general meeting could be exercised by shareholders who held ten per cent or more of the paid up capital. Agenda setting power for general meetings was held by shareholders with five per cent or more of the company's voting rights or 100 members. Many of these protections were in force in the Straits Settlements and Malay states through colonial statutes enacted by the British in the early 20th century.[56] Equitable principles transplanted from England prior to independence from the British continued to impose fiduciary duties on directors. If enforced, these equitable fiduciary duties would be pivotal in providing regulatory protection for shareholders from self-dealing by directors.

There was a slight increase in shareholder protection in 1973 as a result of the introduction of the Kuala Lumpur Stock Exchange's ("KLSE") listing requirements. Prior to 1973, the stock exchanges of Singapore and Malaysia were a single entity which functioned in dual locations after Singapore's separation from Malaysia in

54 Lele & Siems, *supra* note 7.

55 Act 125, Malaysia [*Companies Act*].

56 The *Companies Enactment 1917* (Enactment No. 20 of 1917) of the Federated Malay States is an example of colonial legislation which contained many of the shareholder protections present in Malaysian law in 1965.

1965.[57] The new listing requirements introduced pre-emptive rights which protected minority shareholders from the dilution of their interests in the company without their consent.[58] The new rules also imposed the requirement of shareholder approval for an increase in directors' fees.[59] However, the replaceable rules in Table A of the *Companies Act* had, since 1965, specified that directors' remuneration should be subject to the approval of the general meeting. Hence, the increase in shareholder protection as a result of the requirement of shareholder approval for an increase in directors' fees was marginal. The new listing requirements raised the level of shareholder protection to between 17 and 18 out of a possible maximum of 42.

From 1974 to 1985, the level of Malaysian shareholder protection remained stable. There was a sharp increase in shareholder protection from 1986 to 1988. During this period, the *Malaysian Code on Takeovers and Mergers* was introduced and the *KLSE Listing Requirements* were substantially revised. Amendments to the *Companies Act* in 1986 and 1987 further strengthened shareholder protection.

The amendments to the *Companies Act* during this period contributed significantly to the protection of shareholders from expropriation through related party transactions. Section 132E introduced the requirement of prior shareholder approval for transactions with a director of the company or a person related to a director. The threshold value of acquisitions or disposals of assets which trigger the requirements is set at RM 250,000 (SGD 101,600) or ten per cent of the company's assets. The section imposes criminal penalties for contravention of the provisions. In addition, it requires persons who benefit from the transaction to account for profits. Directors who authorise the transaction are liable to indemnify the company for any loss resulting from the transaction.

Expropriation through related party transactions has been a persistent problem in Malaysian corporate governance.[60] The requirement of shareholder approval and stringent penalties stipulated by s. 132E substantially increased shareholder protection on this issue. Nevertheless, the significance of the contribution made to shareholder protection by s. 132E in comparison with other variables is not reflected in the index as equal weight is attributed to each variable in the template.

Shareholder protection was also strengthened through the insertion of ss. 132C and 132D into the *Companies Act*. Section 132C requires shareholder approval for the disposal of a substantial portion of the company's assets or an acquisition of property of substantial value. Directors are required by s. 132D to obtain shareholder approval prior to issuing shares.

The *Malaysian Code on Takeovers and Mergers* was introduced in 1987.[61] The *Takeovers Code* applies the principle of strict neutrality in takeover situations, prohibiting the board from any action which may lead to the frustration of a takeover

---

57 Tan Pheng Theng, *Securities Regulation in Singapore and Malaysia* (Singapore: Stock Exchange of Singapore, 1978).

58 *KLSE Listing Requirements*, art. 8. Although the Kuala Lumpur Stock Exchange is now known as "Bursa Malaysia", the listing requirements will be referred to as "*KLSE Listing Requirements*" throughout this paper in the interest of consistency.

59 *Ibid.*, art. 27.

60 Wai-Meng Chan, "Expropriation Through Related Party Transactions: The Position in Malaysia" (Paper presented at the International Applied Business Research & International Teaching & Learning College, Orlando, Florida, USA, 4-6 January 2010) [unpublished].

61 *Malaysian Code on Takeovers and Mergers 1987* [*Takeovers Code*].

offer.[62] It also prohibits the issue of shares, entry into contracts of sale and the disposal or acquisition of assets of material amounts which are aimed at frustrating takeover bids.[63]

Revisions to the *KLSE Listing Requirements* in 1988 further increased the level of shareholder protection through additional requirements of disclosure and shareholder approval. The stock exchange enhanced the regulation of related party transactions by requiring that circulars be given to shareholders and their approval be obtained for transactions involving directors or substantial shareholders.[64] Section 281 of the listing requirements mandates shareholder approval for directors' participation in employee share schemes. Notices of meetings called to consider special business are also required to be accompanied by a statement regarding the effect of any proposed resolution.[65] The regulatory reforms between 1986 and 1988 strengthened Malaysian shareholder protection to a moderate level of approximately 21 out of a possible maximum of 42.

This level of shareholder protection was sustained until 1992, when s. 132G was added to the *Companies Act*. This provision prohibited specific related party transactions from being carried out within a set time period. In 1993, listed companies were required to have audit committees with an independent majority.[66] In the same year, the Securities Commission was established. The commission was given the responsibility for the regulation and enforcement of securities law.[67] It was also given more extensive powers of investigation than previous regulatory enforcement bodies. The amendments increased the level of shareholder protection to between 21 and 22 out of a possible maximum of 42. Shareholder protection remained stable from 1994 until the Asian financial crisis in 1997.

Another period of significant growth in shareholder protection following the Asian financial crisis is indicated between 1998 and 2001 in Figure 1. During the crisis, Malaysian corporate governance was subjected to heavy criticism by transnational financial organisations.[68] In response to the substantial loss of confidence in the Malaysian market, the *Malaysian Code on Corporate Governance* was introduced along with a major review of the *KLSE Listing Requirements*.[69] While compliance with the *KLSE Listing Requirements* is mandatory for listed companies, they need not adopt the recommendations of the *Corporate Governance Code 2000*. Listed companies are required to disclose the extent of their compliance with the recommendations of the *Corporate Governance Code 2000* in their annual reports.[70] Listed companies which choose not to comply with its recommendations are required to explain the circumstances justifying their departure from the recommended practices. In summary, the new regulations strengthened shareholder protection through the presence of independent directors and audit, remuneration and nomination committees. Mechanisms were created to safeguard minority shareholders' interests in

---

62 *Ibid.*, r. 4.
63 *Ibid.*, r. 37.
64 *Supra* note 58, ss. 115, 116.
65 *Ibid.*, s. 299.
66 *Ibid.*, s. 15A.
67 *Securities Commission Act 1993* (Act 498, Malaysia), s. 15.
68 Liew, "Perceived Roles", *supra* note 3.
69 *Malaysian Code on Corporate Governance 2000* [*Corporate Governance Code 2000*].
70 *Supra* note 58, r. 15.26.

related party transactions. The regulations also sought to enhance the disclosure of directors' remuneration and the Securities Commission's powers of investigation.

The *Corporate Governance Code 2000* initiated significant structural changes to the board of directors, recommending that one-third of the board should consist of independent directors.[71] Concentrated shareholding is common in Malaysia and appointments to the board are usually made by controlling shareholders.[72] Prior to the *Corporate Governance Code 2000*, minority shareholders had little or no representation on the board. Hence, the *Corporate Governance Code 2000*'s recommendation that the board should have fair representation of the investment of shareholders apart from the significant shareholder[73] constituted a radical departure from the status quo. However, while the *KLSE Listing Requirements* subsequently mandated the one-third independence requirement for boards of listed companies,[74] no mechanisms were created to ensure that minority shareholders were adequately represented on boards. Neither the *Corporate Governance Code 2000* nor the listing requirements specified any procedures for minority shareholders to elect representatives.

The *Corporate Governance Code 2000* also proposes several committees aimed at improving the internal management of companies and enhancing accountability. It recommends that there should be a nomination committee responsible for proposing new nominations to the board and for assessing the effectiveness of the board and the contribution of each director.[75] The nomination committee is to comprise non-executive directors, the majority of whom are independent. The *Corporate Governance Code 2000* also proposes the appointment of a remuneration committee responsible for making recommendations to the board on the remuneration of executive directors. The *Corporate Governance Code 2000* does not specify that the remuneration committee should have any independent directors but suggests instead that all members should be non-executive directors.[76] A third committee proposed by the *Corporate Governance Code 2000* is the audit committee which is responsible for internal audit, liaison with external auditors and reviewing related party transactions. According to the *Corporate Governance Code 2000*, all the members of the audit committee should be non-executive directors and the majority should be independent.[77]

The listing requirements reinforce the recommendations of the *Corporate Governance Code 2000* by mandating the appointment of an audit committee with an independent majority.[78] The listing requirements also facilitate independent review by the audit committee by requiring listed companies to provide the committee with access to information and professional advice.[79] There is no mention of the remuneration and nomination committees in the listing requirements. However, annual

---

71 *Corporate Governance Code 2000*, *supra* note 69, Part 2, AA, III.

72 Philip N. Pillai, *Sourcebook of Singapore and Malaysian Company Law*, 2nd ed. (Singapore: Butterworths, 1986) at 264.

73 *Supra* note 71, Part 2, AA, IV.

74 *Supra* note 58, r. 15.02.

75 *Supra* note 71, Part 2, AA, VIII.

76 *Ibid.*, Part 2, AA, XXIV.

77 *Ibid.*, Part 2, BB, I.

78 The rules also require that the audit committee be chaired by an independent director and one of its members should be an accountant: *KLSE Listing Requirements*, *supra* note 58, r. 15.11.

79 *Ibid.*, r. 15.18.

reports are required to disclose the aggregate directors' remuneration and the number of directors whose remuneration falls within successive bands of RM 50,000 (SGD 20,300).[80] Likewise, the listing requirements do not support the recommendations of the *Corporate Governance Code 2000* that each director's remuneration should be disclosed.[81] The *Corporate Governance Code 2000*'s suggestion that directors' remuneration should be based on performance[82] is similarly not reflected in the listing requirements.

Among the new listing requirements' main contributions to shareholder protection is the creation of mechanisms directed at safeguarding the interests of minority shareholders in related party transactions. Related party transactions in which controlling shareholders were perceived to have benefitted at the expense of minority shareholders were the source of much criticism during the Asian financial crisis.[83] The listing requirements mandate the appointment of independent financial advisers to comment on the fairness of related party transactions to minority shareholders.[84] Specific information relating to the transaction is required to be disclosed in a circular to shareholders and the transactions are subject to shareholder approval.[85] Nevertheless, a range of transactions are exempted from these requirements.[86] Hence, directors are arguably able to circumvent some of these safeguards through carefully structured transactions.

The post-financial crisis regulatory reforms were also aimed at improving the public enforcement of regulations. The *Securities Commission (Amendment) Act 1998* extended the Securities Commission's powers of investigation.[87] It also introduced statutory provisions protecting whistleblowers. The level of shareholder protection was raised to between 24 and 25 out of a possible maximum of 42 as a result of the reforms.

From 2002 to 2006, shareholder protection remained stable. In 2007, several regulatory reforms took place. However, despite the quantity of formal regulations introduced, the substantive effect of the reforms on shareholder protection was marginal. Many of these regulations reiterate protections which were already in existence prior to 2007. Among the reforms which strengthen shareholder protection is the enactment of the *Capital Markets and Services Act 2007* which imposes a duty on auditors to disclose breaches of securities law.[88] The Act also extends the protection afforded to whistleblowers. Following a major review of the *Companies Act* by the

---

80 *Ibid.*, Appendix 9C.

81 *Supra* note 69, Part 1, B, III.

82 *Ibid.*, Part 1, B, I.

83 The purchase by United Engineers Malaysia of Renong's shares was one such incident: William Case, "Malaysia: New Reforms, Old Continuities, Tense Ambiguities" (2005) 41 J. Dev. Stud. 284; Jomo Kwame Sundaram, "Pathways Through Financial Crisis: Malaysia" (2006) 12 Global Governance 489; Liew, "Perceived Roles", *supra* note 3.

84 *Supra* note 58, r. 10.08.

85 Shareholder approval is required where any of the percentage ratios is equal to or exceeds five percent. Percentage ratios are calculated on the basis of the value of the assets compared with the net tangible assets of the listed issuer. Alternative measures are based on net profits, value of the consideration or equity share capital: *ibid.*, r. 10.02.

86 *Ibid.*, rr. 10.08, 10.09.

87 (Act A1041, Malaysia).

88 (Act 671, Malaysia).

Corporate Law Reform Committee, amendments to the *Companies Act* in 2007 introduce a statutory derivative action[89] and an objective standard to the directors' duty of care.[90] Nevertheless, the effect on the level of shareholder protection is minimal as the duty of care is limited[91] and many of the amendments constitute codifications of existing equitable principles. The reforms raised the level of shareholder protection to a moderate level of between 25 and 26 out of a possible maximum of 42. Between 2007 and 2010, the level of shareholder protection remained stable. The period of the study ends with the level of shareholder protection against directors between 25 and 26 out of a possible maximum of 42.

B. *Protection Against Other Shareholders*

The sub-index in Figure 2 shows the growth in shareholder protection against other shareholders in Malaysia between 1965 and 2010. The horizontal axis indicates the progression over time from 1965 to 2010, while the level of shareholder protection against other shareholders is indicated by reference to the vertical axis. 18 variables are examined in this sub-index,[92] and the level of shareholder protection against expropriation by other shareholders in the vertical axis is measured against a possible maximum score of 18. These variables cover issues relating to voting including supermajority requirements, quorums, the 'one share one vote' principle, cumulative and multiple voting rights. Shareholders' exit rights such as mandatory offers in relation to takeover bids and the compulsory acquisition of minority shareholding are considered. The disclosure of major share ownership and the rights of oppressed minorities are examined in addition to questions as to whether various aspects of shareholder protection are mandatory.

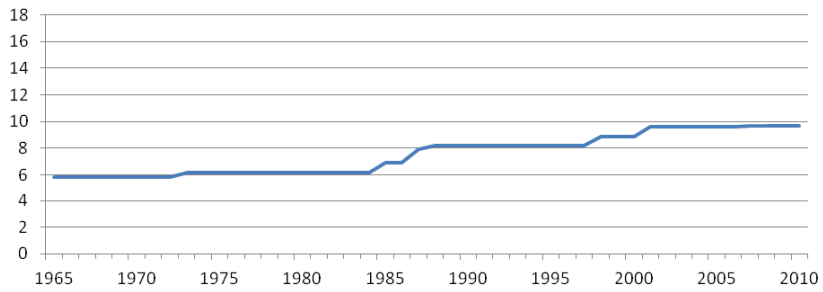

Figure 2. Shareholder protection against other shareholders (18 variables) in Malaysia from 1965-2010.

Figure 2 indicates that the level of protection against other shareholders in 1965 was less than six out of a possible maximum of 18. The protections include the requirement that the approval of shareholders representing at least three-quarters of

89 *Supra* note 55, s. 181A.
90 *Ibid.*, s. 132(1A).
91 *Ibid.*, s. 132 exempted directors from liability on grounds of reasonable reliance on information or a delegation of duties made in good faith.
92 Lele & Siems, *supra* note 7.

voting rights should be obtained for any amendment of the articles of association[93] or schemes of arrangement with creditors.[94] English common law principles[95] which allow shareholders to file a claim against a void or voidable resolution of the general meeting are applicable in Malaysia.[96] Shareholders have the right to seek relief from oppressive conduct or disregard of their interests by controlling shareholders through the statutory remedy for oppressed minorities[97] or winding up on just and equitable grounds.[98] The 'one share one vote' rule is applicable in Malaysia.[99] Malaysian regulations which do not permit directors' duties to be excluded in the articles of association also contribute to the level of shareholder protection.

The level of shareholder protection remained stable from 1965 to 1972, increasing in 1973 when the *KLSE Listing Requirements* were established. The listing requirements stated that directors who had an interest in related party transactions and held shares in the company should abstain from voting at the general meeting. The restriction against directors voting at the general meeting is ambiguous as such meetings usually involve voting by shareholders rather than directors. It is probable that the aim of this provision was to restrict voting by shareholders who were also directors in situations where they may have had an interest in the related party transaction. In 1988, the rule was replaced with a statement that the stock exchange had the right to require directors or substantial shareholders to abstain from voting.

The first significant increase in shareholder protection is shown in Figure 2 between 1985 and 1988. As with protection against the board, the increase came about as a result of substantial regulatory revision during this period. Among these were amendments to the *Companies Act* which mandated the disclosure of shareholding of five per cent of the company's voting rights.[100] The *Takeovers Code* provided for a mandatory bid for the entirety of the shares where there was an acquisition of 33 per cent or more of the voting rights.[101] The revision of the *KLSE Listing Requirements* in 1988 required all directors to retire from office at least once in three years.[102]

Following the regulatory reforms, the level of shareholder protection increased to a moderate level of approximately eight out of a possible maximum of 18, remaining stable from 1989 to 1997. The threshold for disclosure of substantial shareholding was amended from five per cent to two per cent of the company's voting shares in 1998.[103] However, the change was short-lived and, in 2001, the threshold reverted to five per cent of the company's voting shares.

---

93 *Companies Act*, *supra* note 55, s. 31.

94 *Ibid.*, s. 176.

95 *Edwards v. Halliwell* [1950] 2 All E.R. 1064 (C.A.).

96 *Supra* note 53.

97 *Companies Act*, *supra* note 55, s. 181.

98 *Ibid.*, s. 181; *Tay Bok Choon v. Tahansan Sdn. Bhd.* [1987] 1 M.L.J. 433 (P.C.); *Tien Ik Enterprises Sdn. Bhd. v. Woodsville Sdn. Bhd.* [1995] 1 M.L.J. 769 (S.C.).

99 *Companies Act*, *ibid.*, s. 147.

100 *Ibid.*, ss. 69D, 69L.

101 *Supra* note 61, s. 9.

102 *Supra* note 58, s. 9. Prior to this, art. 63 of Table A, which is a replaceable rule, provided that directors should retire once every three years.

103 *Securities Industry (Reporting of Substantial Shareholding) Regulations 1998*.

Amendments to the *KLSE Listing Requirements* in 1998 brought about significant changes to the regulation of related party transactions, an issue which had attracted considerable criticism during the Asian financial crisis. The revised listing requirements attempted to address the imbalance of power resulting from the concentrated holdings of dominant shareholders. Rule 10.08 of the listing requirements restricts voting by directors and majority shareholders who have an interest in related party transactions. Persons connected with them are also required to abstain from voting at the general meeting.[104] These voting restrictions are in addition to the disclosure requirements and independent advice previously mentioned in relation to shareholder protection against directors. The increase in protection against other shareholders is also attributed to the new listing rule which directs that one-third of a listed company's board should consist of independent directors.[105] The *Corporate Governance Code 2000*, likewise, sought to contribute to minority shareholder protection by recommending that where there is a significant shareholder, the board should have fair representation of the investment of other shareholders. However, in contrast with the listing requirements, compliance with this recommendation is optional and there are no mechanisms specifically aimed at facilitating minority shareholder involvement in board appointments. Figure 2 reflects the increase in the level of shareholder protection to between nine and ten as a result of the reforms.

The review of the *Companies Act* in 2007 introduced a statutory derivative action for oppressed minorities.[106] Prior to this, s. 181 of the *Companies Act* provided shareholders with a remedy against oppression. A derivative action was also available under common law. The company could also be wound up on just and equitable grounds. Hence, although the statutory derivative action strengthened shareholder protection, the increase in the level of protection was marginal due to the existing protection for oppressed minorities. At the end of the period of the study, the level of shareholder protection remained below ten out of a possible maximum of 18.

C. *Aggregate Shareholder Protection*

Figure 3 shows the aggregate shareholder protection consisting of both protections against the board and protections against other shareholders from 1965 to 2010. The aggregate shareholder protection measured against 60 variables[107] reflects the trends in both Figures 1 and 2 of the highest growth in shareholder protection occurring from 1985 to 1988 and from 1998 to 2001. There is an overall increase and upward trend in the aggregate shareholder protection over the period 1965 to 2010. Figure 3 indicates that most of the growth in shareholder protection occurred from the mid-1980s. The level of shareholder protection increased by more than 11 points between 1985 and 2010 in contrast with the gain of slightly over one point between 1965 and 1984.

---

[104] *Supra* note 58, rr. 10.08, 10.09.
[105] *Ibid.*, r. 15.02.
[106] *Companies Act*, *supra* note 55, s. 181A.
[107] Lele & Siems, *supra* note 7.

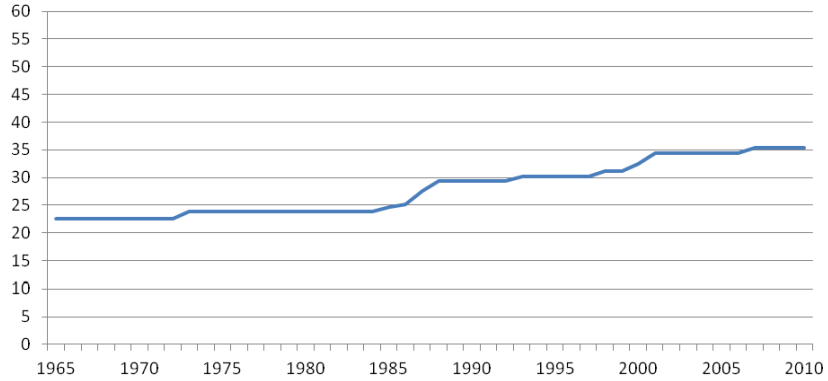

Figure 3. Aggregate shareholder protection (60 variables) in Malaysia from 1965 to 2010.

V. Comparison with Other Countries

This section considers the strength of Malaysian shareholder protection *vis-à-vis* the strength of shareholder protection in Australia, France, Germany, India, the UK and the US. It draws from the analyses by Anderson *et al.* and Lele and Siems on shareholder protection in these countries.

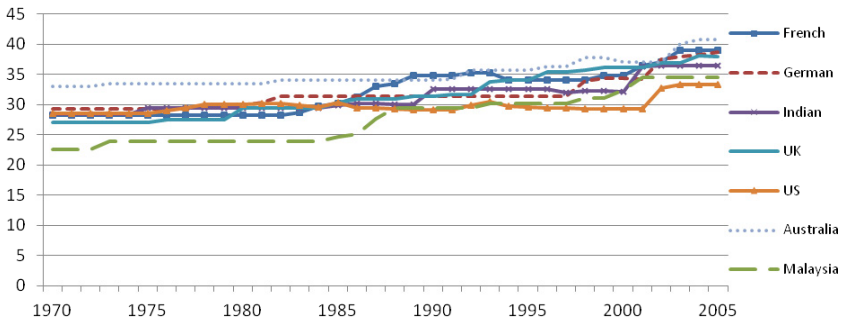

Figure 4. Aggregate shareholder protection (60 variables) in seven countries from 1970-2005.

The aggregate shareholder protection in each of the seven countries between 1970 and 2005 is indicated in Figure 4. Figure 4 shows an upward trend in aggregate shareholder protection across all the countries in the sub-index. At the start of the period, the level of aggregate shareholder protection in Malaysia was the lowest of all the countries. By the late 1980s, Malaysia's aggregate shareholder protection had reached the level of shareholder protection of the US. Between 1998 and 2001, Malaysian levels of protection momentarily reached that of India and Germany. However, after 2001, Malaysian shareholder protection stabilised while German shareholder protection continued to increase. Lele and Siems suggested that there was significant improvement in aggregate shareholder protection between 2000 and 2005 among the countries in their study. The data on aggregate shareholder protection

in Australia likewise indicated similar growth in shareholder protection during this period. Shareholder protection in Malaysia followed a different trajectory during this period, with an increase in shareholder protection in 1998, after the Asian financial crisis, followed by a period of stability between 2001 and 2007.

At the end of the period in 2005, the level of aggregate shareholder protection in Malaysia was higher than the aggregate shareholder protection in the US but lower than that of France, Germany, India, Australia and the UK. Nevertheless, Malaysia had the highest rate of increase in aggregate shareholder protection among the seven countries between 1970 and 2005.

Notably, the strength of Malaysian shareholder protection was not closer to the UK or Australia than the civil law countries in the index despite Malaysian companies regulations having been modelled after the UK's regulations and, to a lesser extent, Australian law. Conversely, while Australian shareholder protection was the highest among all the countries, Malaysian shareholder protection was at the bottom of the index, second only to the US. Malaysia's level of shareholder protection was below that of France and Germany, the civil law countries in the study. Nevertheless, Malaysia is a developing country while Germany and France are developed countries. Armour *et al.* note the tendency for developing countries to have lower levels of shareholder protection than developed countries.[108] Their analysis of shareholder protection in 20 countries from 1995 to 2005 based on ten variables found that when developing common law countries were compared with developing civil law countries, common law countries had a higher level of shareholder protection.[109]

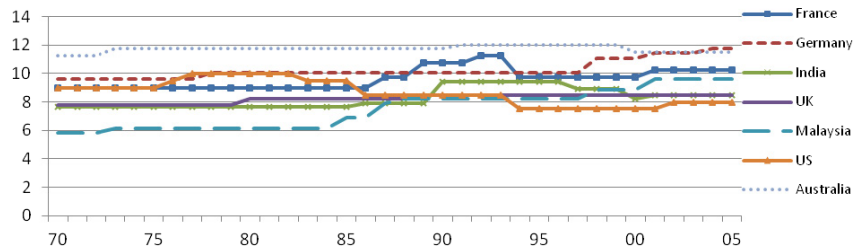

Figure 5. Shareholder protection against other shareholders (18 variables) in seven countries from 1970 to 2005.

Figure 5 indicates the trajectory of protection against other shareholders in the seven countries from 1970 to 2005. Figure 5 shows that at the start of the period Malaysia's level of protection against other shareholders was lower than all the other countries in the index and maintained an upward trend throughout the period of the study. The upward trend was shared by Germany. The UK and Australia had a higher level of stability. India, France and the US experienced some fluctuation with India and France having an overall increase in protection against other shareholders by the end of the period. In contrast, the US ended the period with an overall decrease in protection against other shareholders. Malaysia had the highest rate of increase in protection against other shareholders. At the end of the period its level of protection

[108] Armour *et al.*, "Shareholder Protection and Stock Market Development", *supra* note 18.

[109] *Ibid.* Nevertheless, shareholder protection in civil law countries appeared to be increasing at a faster rate, indicating a trend towards convergence across legal traditions: Siems, *supra* note 50.

against other shareholders was above that of the US, UK and India but below France, Germany and Australia.

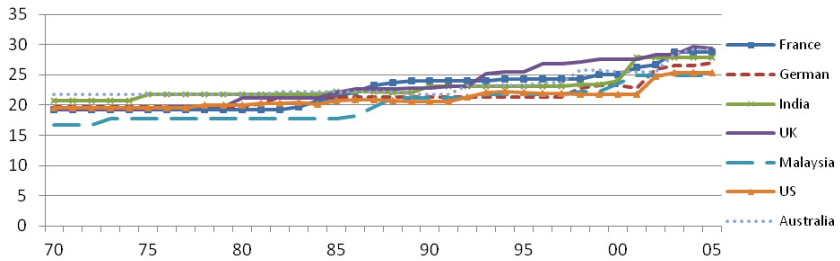

Figure 6. Shareholder protection against the board of directors (42 variables) in seven countries from 1970 to 2005.

Figure 6 shows the relative shareholder protection against the board of directors in the seven countries between 1970 to 2005. As in Figures 4 and 5, Malaysia's level of shareholder protection was below that of the other countries at the start of the period. However, it reached the level of the US's protection against the board towards the end of the 1980s and in 1993 marginally exceeded Germany's level of protection. Figures 4 and 6 indicate that both Malaysia and India, the two Asian countries in the studies, experienced a sharp increase in aggregate shareholder protection and protection against the board between 1999 and 2001, although in India the greatest period of growth occurred from 2000 to 2001. Shareholder protection in both Malaysia and India remained stable after 2001 while there was growth in aggregate shareholder protection and protection against the board in the other countries. When Malaysia's level of shareholder protection moved into a period of stability after the Asian financial crisis reforms, it was overtaken by Germany and the US. At the end of the period, Malaysia's level of shareholder protection against the board remained below that of the other countries. There was an overall increase in protection against the board in all the countries.

Figures 5 and 6 indicate that Malaysia's protection against shareholders relative to the other countries is significantly stronger than its protection against the board. As at 2005, Malaysia's shareholder protection against other shareholders was higher than the US, UK and India and was just below that of France. This is consistent with the finding of better shareholder protection against other shareholders in countries which have a higher incidence of concentrated share ownership.[110] Lele and Siems suggest that the need for protection against other shareholders is greater in countries in which public companies are dominated by holders of large blocks of shares.[111]

In the Malaysian context, shareholder protection against the board of directors is arguably of equal importance with protection against other shareholders. Concentrated shareholding is common among Malaysian companies and control is further enhanced by pyramid shareholding structures and cross-holdings.[112] Pyramid structures and participation in management allow dominant shareholders to exercise

[110] Lele & Siems, *supra* note 7.

[111] *Ibid.*

[112] Stijn Claessens, Simeon Djankov & Larry H.P. Lang, "The Separation of Ownership and Control in East Asian Corporations" (2000) 58 Journal of Financial Economics 81.

control over the company in excess of their voting rights.[113] Controlling shareholders often dominate the board of directors.[114] Hence, minority shareholders in Malaysia are vulnerable to expropriation by controlling shareholders not only in their capacity as shareholders but also through their control of the board.

The comparison between Malaysian shareholder protection and that of the US also suggests an inconsistency with La Porta *et al.*'s claim that the strength of shareholder protection determines ownership concentration. Figures 4 and 6 show that from the late 1980s, Malaysia and the US had similar levels of aggregate shareholder protection and protection against boards. Nevertheless, the US and Malaysia have widely differing patterns of ownership dispersion. Malaysia's concentrated share ownership contrasts with the dispersed share ownership in the US.[115]

Most of the regulatory protections adopted in Malaysia over the period of the study were modelled after UK regulations. Nevertheless, Figures 4, 5 and 6 indicate a marked difference in the level of shareholder protection between the two countries. One possible explanation for this difference is the lapse of time between the coming into force of protections in the UK and their adoption in Malaysia. For instance, various protections in relation to takeovers and mergers which were in force in the UK in 1965 were only adopted in Malaysia in 1987.[116] This appears to be consistent with Pistor *et al.*'s observation of lethargy in common law transplant countries.[117] Persistent divergence in the specific areas of directors' remuneration and duty of care also contributes to the difference in the protective strength of regulations in the UK and Malaysia. Other studies have also observed that developing countries have weaker regulatory protections for shareholders than developed countries.[118]

In coding Malaysian shareholder protection, several issues warrant consideration. These centre on the disparity of power between dominant shareholders and minority shareholders. Although shareholders theoretically have the power to nominate and appoint directors, the concentration of control in Malaysia results in the appointment of boards being dominated by controlling shareholders.[119] Likewise, limits on the duration of directors' appointments are ineffective in protecting minority shareholders who in reality have little or no actual role in directors' appointments.

---

[113] Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "Corporate Ownership Around the World" (1999) 54 The Journal of Finance 471.

[114] OECD, *White Paper on Corporate Governance in Asia* (2003), online: OECD <http://www.oecd.org/daf/ca/corporategovernanceprinciples/25778905.pdf>.

[115] Their examination of ownership concentration in the ten largest non-financial firms found that the three largest shareholders owned a mean of 19 per cent in the UK, 20 per cent in the US and 28 per cent in Australia. In contrast, the three largest shareholders in Malaysia owned a mean of 54 per cent of the shares in the ten largest non-financial firms: Rafael La Porta *et al.*, "Law and Finance" (1998) 106 Journal of Political Economy 1113.

[116] The *Corporate Governance Code 2000*, *supra* note 69, was based on UK, Committee on the Financial Aspects of Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance* (London: Burgess Science Press, 1992) (Chair: Adrian Cadbury) and *Code of Best Practice*. Subsequent revision of the *Corporate Governance Code 2000* in 2007 did not incorporate the more stringent standards of independence and transparency in the UK's *Combined Code on Corporate Governance 2003*. The most recent revision of the *Malaysian Code on Corporate Governance* in 2012 has adopted some of the independence requirements prescribed in the UK's *Combined Code on Corporate Governance 2003*.

[117] Pistor *et al.*, *supra* note 22.

[118] Siems, *supra* note 50.

[119] Pillai, *supra* note 72.

While shareholders are entitled to file a claim against a resolution by the general meeting, the lack of access to information, financial constraints and difficulty of obtaining concerted action significantly deter minority shareholders from exercising such rights.[120]

The existence of formal protections which are in reality not accessible to minority shareholders due to controlling shareholders' dominance arguably masks the weakness of substantive protections in problematic areas such as related party transactions. A reconstructed index which gives greater recognition to the vulnerability of minority shareholders to expropriation by controlling shareholders who dominate the board may reveal a different pattern of the protective strength of Malaysian regulation.[121]

VI. Discussion

Two key findings of this analysis are highlighted in this section. The first relates to the mechanisms by which legal origin has influenced the evolution of Malaysian shareholder protection. The influence of English common law on Malaysian regulation is better explained by institutional complementarities as posited by the weak form legal origins hypothesis. Secondly, the inadequacy of focussing on formal regulatory reform is underscored. The analysis of Malaysian shareholder protection demonstrates the need to consider the implementation of law in the context in which it operates.

A. *The Influence of Legal Origins*

As mentioned earlier, the legal origins scholarship proposes several mechanisms by which legal origins influence the evolution of law. The mechanisms proposed by the strong form hypothesis are the 'adaptability channel' and the 'judicial channel'. The weak form legal origins hypothesis argues that the flow of ideas within legal families

---

[120] Philip T.N. Koh, "Corporate Governance in Malaysia: Reforms in Light of Post-1988 Crisis" in Ho Khai Leong, ed., *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (Singapore: Institute of Southeast Asian Studies, 2005) 104; Boo Yeang Khoo, "Review of Corporate Governance in Asia: Corporate Governance in Malaysia" (18 August 2004), online: Asian Development Bank Institute <http://www.adbi.org/conf-seminar-papers/2004/08/18/532.corporate.governance.malaysia/>; Elsa Satkunasingam & Bala Shanmugam, "The Consequences of Culture on Shareholder Activism in Malaysia" (2006) 4 Journal of Applied Management and Accounting Research 45.

[121] The template developed by the Cambridge group considers a wide range of issues relating to shareholder protection. However, there is a notable gap on a significant problem in Malaysian shareholder protection, namely the expropriation of minority shareholders by controlling shareholders. Such expropriation is often thought to be carried out through related party transactions. Variable 1(7) of the template for protection against the board considers the issue of expropriation by directors through related party transactions. There is no equivalent variable for protection against other shareholders. Nevertheless, s. 132G of the *Companies Act* which was introduced in 1992 prohibited specific related party transactions involving shareholders. Likewise, revisions to the *KLSE Listing Requirements* in 1988 and 1998 have strengthened the protection for minority shareholders from expropriation through related party transactions. The amendments in 1998 further prohibit interested shareholders from voting. Various transactions are exempted from these requirements, however, arguably permitting transactions to be structured so as to avoid the safeguards stipulated in r. 10.08.

is facilitated primarily through "affinities of legal thought and language".[122] Path dependence is viewed as an "efficient adaptation to the previously transplanted legal infrastructure".[123]

The evolution of Malaysian shareholder protection provides little support for both the judicial and adaptability channels. Judicial independence has been curbed by the executive since the Lord President was removed from office in 1988.[124] The lack of judicial independence has persisted since then,[125] excluding the judicial channel hypothesis from the evolution of Malaysian shareholder protection from 1988. The adaptability channel does not offer a much more plausible explanation for the evolution of Malaysian shareholder protection as most of the growth in shareholder protection between 1965 and 2010 was based on legislation and codes. Judicial decisions had a negligible role in the growth in shareholder protection over the period of the study. The director's duty of care and skill was among the few variables in which legal change was propelled by judicial decisions in the UK and Australia between 1992 and 1994.[126] These significant judicial decisions were not followed by the Malaysian courts, and legislative reform was required in 2007 to facilitate legal change. Hence, the claim of greater efficiency being facilitated through incremental adaptation to changing economic circumstances by way of judicial decisions is difficult to sustain in relation to the evolution of shareholder protection in Malaysia. Further inconsistency with the adaptability channel is reflected in the pattern of growth in shareholder protection. Most of the growth in Malaysian shareholder protection occurred rapidly over several short periods rather than incrementally. These periods of rapid growth were interspersed between longer periods of relative stability.

The weak form legal origins hypothesis has stronger explanatory power for the pattern of persistent drawing from the regulations of English common law countries. There is evidence that the "affinities of legal thought and language" have had a significant role in facilitating the borrowing from common law countries. Liew's survey found that the key players involved in the regulatory reforms following the Asian financial crisis were more inclined to adopt UK regulations on grounds of their familiarity. This, in turn, was facilitated by Malaysia's inheritance of its legal system from the British and the common practice of Malaysians obtaining their legal education in the UK and other common law countries such as Australia.[127] The influence of regulations from other common law countries is often seen in Malaysian law reform processes. In considering the post-Asian financial crisis reforms, explicit reference was made to the regulations of a wide range of common law countries.[128]

---

[122] Armour *et al.*, "How Do Legal Rules Evolve?", *supra* note 6 at 598.

[123] Botero *et al.*, *supra* note 17 at 1346.

[124] A.J. Harding, "The 1988 Constitutional Crisis in Malaysia" (1990) 39 I.C.L.Q. 57.

[125] International Bar Association, *Justice in Jeopardy: Malaysia 2000* (2000); Ahmad Fadzel, "Judicial Independence in Australia and Malaysia", online: Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=929856>.

[126] *Re D'Jan of London* [1994] 1 B.C.L.C. 561 (Ch.); *A.W.A. Ltd v. Daniels* (1992) 10 A.C.L.C. 933 (Comm. D.).

[127] Pik Kun Liew, "Corporate Governance Reforms in Malaysia: the Key Leading Players' Perspectives" (2007) 15 Corporate Governance 724.

[128] Finance Committee on Corporate Governance, *supra* note 4; Malaysia, Corporate Law Reform Committee, *Review of the Companies Act 1965—Final Report* (2008).

These included Singapore, Canada, New Zealand, Hong Kong, Australia and the UK. Malaysia's first companies legislation enacted after independence was drafted with the assistance of an Australian draftsman.[129] Many of its provisions bore a close resemblance to both Australian and English companies legislation. Apart from similarities in legal institutions, the borrowing from other common law countries may also have been facilitated by language. English is still widely used in the Malaysian legal system.

Consistency with the weak form legal origins hypothesis is also reflected in the timing of legal change in Malaysia. The periods of substantial growth occurred immediately after economic shocks. The periods of strong growth from 1986 to 1988 and in the late 1990s were preceded by the economic recession in 1985[130] and the Asian financial crisis respectively.[131] Several significant corporate scandals occurred in the mid-1980s which resulted in trading on the stock exchange being suspended.[132] Parliamentary debates reflected an awareness of the vulnerability of minority shareholders to fraudulent dealings by directors.[133] The introduction of the *Takeovers Code* in 1987 was preceded by the substantial growth of large corporate conglomerates stimulated by privatisation of state-owned enterprises pursuant to government policy.[134] The expansion of corporate conglomerates was also achieved through mergers and acquisitions which were at times aggressive and hostile.[135] The incidence of rapid growth in shareholder protection following significant economic events is consistent with Armour *et al.*'s proposition that legal systems are to some degree endogenous to their economic contexts. Strong growth in shareholder protection immediately after the Asian financial crisis is also reflected by India, the only other Asian country among the seven countries compared.[136]

---

[129] Ben Chan Chong Choon, Philip Koh Tong Ngee & Peter Ling S.W., *Chan & Koh on Malaysian Company Law: Principles and Practice*, 2nd ed. (Malaysia: Thomson Reuters, 2006).

[130] Ming-Yu Cheng, "Economic Fluctuations and Growth: An Empirical Study of the Malaysian Economy" (2003) 7 Journal of Business in Developing Nations 51.

[131] While the period of growth in 1973 was less robust than in the mid-1980s and after the Asian financial crisis, it was nonetheless preceded by the commodities crisis. It is not clear whether the commodities crisis had an influence on legal change during this period. The emergence of the listing requirements appears to coincide with the separation of the Kuala Lumpur Stock Exchange from its Singaporean counterpart. Regulatory reform in 2007 was arguably influenced, in part, by the post-Asian financial crisis prescriptions. In reviewing the *Companies Act*, the Corporate Law Reform Committee referred to the Finance Committee on Corporate Governance's recommendations.

[132] Sing., Monetary Authority of Singapore, *Case Study on Pan Electric Crisis* (Staff Paper No. 32) by Mimi Ho *et al*. (June 2004), online: Monetary Authority of Singapore <http://www.mas.gov.sg/about-mas/monographs-and-information-papers/staff-papers/2004/mas-staff-paper-no32-jul-2004.aspx>.

[133] Malaysia, Senate, *Parliamentary Debates*, vol. 1, no. 12 (16 December 1986).

[134] K.S. Jomo, ed., *Privatizing Malaysia: Rents, Rhetoric, Realities* (Boulder: Westview Press, 1995).

[135] Kok Swee Kheng, *Malaysia to 2003: From Redistribution to Growth* (London: Economist Intelligence Unit, 1994) at 17; Rajeswary Ampalavanar Brown, *The Rise of the Corporate Economy in Southeast Asia* (London: Routledge, 2006) at 165; Edmund Terence Gomez, *Chinese Business in Malaysia: Accumulation, Accommodation and Ascendance* (Richmond: Curzon, 1999).

[136] Nevertheless, reports indicate that India emerged relatively unscathed by the Asian financial crisis: Arunabha Ghosh, "Pathways Through Financial Crisis: India" (2006) 12 Global Governance 413 at 424; "IMF Lauds India for Avoiding the Asian Financial Crisis" *India Economic News* (May 1999), online: Indian Embassy <https://www.indianembassy.org/enews/econews(may99).pdf>.

B. *Implementation in a Domestic Context*

The evolution of Malaysian shareholder protection underscores the limitations of the legal origins thesis in its focus primarily on formal regulation, with minimal consideration of implementation and context. Anecdotal evidence indicates that the post-Asian financial crisis reforms appear to be 'form over substance'.[137] The question as to why the Malaysian reforms have not produced substantive protection for minority shareholders as might have been anticipated is one that would benefit from further research. Preliminary research suggests the need to consider the prevailing norms and political economy in the country receiving the reforms. Scholars argue that practices which are deeply rooted in socio-cultural norms are more difficult to reform than formal law.[138] Milhaupt and Pistor assert that legal transplants necessarily involve a process of adaptation to the local context. They argue that the implementation of regulations is affected by the complementarity between the political economy and values embodied in the transplant.[139] This leads to the issue of 'fit' between the transplanted law, Malaysian norms and political economy.

Malaysian socio-cultural norms are at odds with the values embodied by the post-Asian financial crisis reforms in several ways. Like many other East Asian countries, norms of collectivism, consensus and deference to authority are valued in Malaysia.[140] Independent directors were among the significant reforms introduced after the crisis. Independence, however, presupposes a willingness to depart from groupthink. Active monitoring of related party transactions may require questioning which runs counter to cultural values of 'face' preservation. Hierarchical social structures[141] contrast with egalitarian values espoused by protections for minority shareholders. Khoo highlights the "social and cultural sensitivities" encountered by the board and its committees in assessing directors' performance and recommending their remuneration.[142] He argues that performance evaluation is usually the prerogative of superiors. The problem is particularly acute where controlling shareholders are also directors, a situation commonly found in Malaysia.[143] In prescribing the transplantation of Anglo-American regulations into East Asia, little consideration appears

---

137 Janine Pascoe & Shanthy Rachagan, "Key Developments in Corporate Law Reform in Malaysia" [2005] Sing. J.L.S. 93; Liew, "Perceived Roles", *supra* note 3; Khoo, *supra* note 120.

138 Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambrige University Press, 1990); Curtis J. Milhaupt & Mark D. West, *Economic Organizations and Corporate Governance in Japan: The Impact of Formal and Informal Rules* (Oxford: Oxford University Press, 2004). In examining legal development in Southeast Asia, Harding finds that legal transplants are modified by their domestic social context. He argues that legal transplants are at times implemented in ways which differ significantly from their countries of origin. He attributes this to the inconsistency between local cultural values and the Western concepts embodied in transplants: Andrew Harding, "Global Doctrine and Local Knowledge: Law in South East Asia" (2002) 51 I.C.L.Q 35 at 45.

139 Curtis J. Milhaupt & Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development Around the World* (London: University of Chicago Press, 2008).

140 Raduan Che Rose *et al.*, "A Face Concern Approach to Conflict Management—A Malaysian Perspective" (2007) 2 Journal of Social Sciences 121; Geert H. Hofstede, Gert Jan Hofstede & Michael Minkov, *Cultures and Organizations: Software of the Mind: Intercultural Cooperation and its Importance for Survival*, 3rd ed. (New York: McGraw-Hill, 2010).

141 Hofstede, Hofstede & Minkov, *ibid.* at 60.

142 Khoo, *supra* note 120 at 22.

143 *Ibid.*

to have been given to these conflicts between the values embodied by transplanted regulations and domestic socio-cultural norms.

Criticisms of the Malaysian reforms as 'form over substance' also raises questions as to whether transplanting regulations from the UK adequately addresses the pertinent corporate governance problems encountered in the Malaysian context. The prevalence of self-dealing has been linked to concentrated shareholding in Malaysia.[144] The dominance of controlling shareholders is further intensified through pyramid structures and participation in management.[145] The agency problem in this context is centred on the disparity of power between dominant and minority shareholders.[146] Regulations in the UK were likely to have been formulated to address the agency problems encountered in the UK. These agency problems are likely to be different given the widely differing patterns of share ownership in both countries.[147]

VII. Conclusion

The analysis of Malaysian shareholder protection raises questions on the efficacy of external forces in pressuring countries into effecting formal regulatory reforms without the accompanying internal motivation to effect substantive change. The issues central to the post-Asian financial crisis reforms were closely associated with political economy and socio-cultural norms. Criticism by international financial organisations and the withdrawal of foreign investment due to the loss of confidence in the Malaysian markets pressured the Malaysian authorities into formal regulatory reforms. Hence, the reforms were motivated by the need to placate foreign investors rather than any domestic demand for substantive change in shareholder protection regulation. This dichotomy is reflected in then Prime Minister Dr. Mahathir's remark: "[w]e try to follow [the IMF programmes] not because we think the IMF is right, but because if we don't then there will be a loss of confidence… So we try to show that we are with the IMF".[148] Deeply rooted social values, however, are less amenable to change than formal regulations. Likewise, when proposed reforms run counter to the country's political economy, the political will to effect substantive reforms may also be lacking. Perhaps if transnational regulatory reform policies were to give more consideration to the specific institutions of individual countries, reforms may produce more substantive results than a one size fits all approach.

---

144 Finance Committee on Corporate Governance, *supra* note 4.

145 Claessens, Djankov & Lang, *supra* note 112.

146 Janine Pascoe, "Corporate Law Reform and Some 'Rule of Law' Issues in Malaysia" (2008) 38 Hong Kong L.J. 769; Liew, "Perceived Roles", *supra* note 3.

147 Bebchuk and Hamdani argue that the need for regulatory protection against expropriation varies substantially according to corporate ownership structures. The fundamental concern in companies with dispersed shareholding is expropriation by management. In contrast, companies with controlling shareholders face challenges in relation to controlling shareholder opportunism: Lucian A. Bebchuk & Assaf Hamdani, "The Elusive Quest for Global Governance Standards" (2009) 157 U. Pa. L. Rev. 1263.

148 A. Shameen & S. Oorjitham, "I've Lost My Voice" *Asiaweek* (27 March 1998), online: Asiaweek <http://www-cgi.cnn.com/ASIANOW/asiaweek/98/0327/cs4.html>.