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Malaysian SMEs experience toward effective corporate governance Adaptability and Challenges

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- Ibrahim, H., & Samad, F. A. (2011). Corporate governance mechanisms and performance of public-listed family-ownership in

environment for SMEs (Bank Negara Malaysia, 2006). (Kiggundu, 2002) finds that, the reason behind the failure of many SMEs is due to lack of competencies among the business owners, also alack of skills and abilities among the people holding management positions (C. O. Longenecker, Simonetti, & Sharkey, 1999). Moreover, there is no corporate governance code for the Malaysian SMEs, which supposed to control firms.

8. Conclusion

In Malaysia, SMEs are the backbone contributor the country's GDPAs and also it has a good share in the employment sector. The Malaysian government is working for the betterment of the SMEs, as they introduced ninth Malaysia plan. Not only that, the SME Corp is also found and involved in the policy making and taking robust steps to strengthen the Malaysian SMEs. Instead of that, it can be seen that the Malaysian code for corporate governance put their positive mark on the public listed companies. Public listed companies are directed to perform according to the corporate governance code. Hence, they are performing better as compared to the SMEs.

Malaysian SMEs are family controlled and having concentrated ownership. It allows majority shareholder to expropriate the minority shareholders rights. Similarly, they appoint their kin and close friends on the board of directors and also on the management positions. This allows them to expropriate shareholders rights. As there is no corporate governance code available form to control SMEs and their ownership in Malaysia. Finally, it is concluded that Malaysian government should take necessary actions to cope with these issues in Malaysian SMEs.

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these issues occur due to concentrated ownership (Claessens et al., 2000). Most of thecompany owners, directors and secretaries are found involved in various fraudulent activities. For instance, CCM published few fraudulent cases, offenders' names with the amount they penalized and imprisonment time. Most of the directors and secretaries were found guilty in unauthorized use of company property, making false statements to the CCM, gaining benefits for themselves, offering illegal investment and withdrawing company's funds without approval (CCM, 2012).

Malaysian SMEs are family concentrated companies, where most of the SMEs are run by families themselves with concentrated ownership (Claessens et al., 2000). Many Malaysian SMEs are family owned and controlled by the majority shareholder. Most of these companies are inherited by their own children. Numerous studies have been carried out on the majority shareholders and expropriations of minority shareholders' rights in Malaysia (Ahmad & Seet, 2009; Chong & Phillips, 2012;Himmelberg et al., 2004). Nevertheless, Malaysia is a different case with respect to agency problem; here agency problem occurs between majority and minority shareholders. Indeed, (Lai & Yap, 2004), mentioned that the agency problem in Malaysian firms arises between the majority and minority shareholders. In such case, majority shareholders have the power of control over minority shareholders (Claessens et al., 2002).

Ownership concentration, fraudulent activities of majority shareholders, illegal investment schemes and other issues discussed, are the major barriers to the development of Malaysian SMEs. Although, these issues have indicated that, Malaysian SMEs have failed to follow instructions from CCM and other regulatory authorities for better corporate performance. Due to these issues, 50 percent of the SMEs collapsed during their first five years of operations (Khalique, Shaari, Abdul, Isa, & Ageel, 2011) and also the failure rate of Malaysian SMEs is quite high, approximately 60 percent (Ahmad & Seet, 2009). The Malaysian government is working to reduce the SMEs failure rate by providing different programs, such as the establishment of SME bank in 2005 was one of the initiatives to cope with this problem. Furthermore, other programs were also undertaken to curb this issue, such as; enhancing productivity and quality through modernization and automation of machinery, promoting and increasing production efficiency, product development, encouraging SMEs to start R&D programs, and creating amore conducive business

7.Malaysian SMEs and CORPORATE GOVERNANCE

Effective corporate governance practices lead firms toward good corporate performance. The Malaysian Code of Corporate Governance was only implemented to the public listed companies in Bursa Malaysia to control and monitor firm's performance according to the corporate governance standards. Similarly, Companies Commission of Malaysia (CCM) is working to meet the good corporate governance practices for the SMEs in the country. CCM is an agency that incorporates companies, registers businesses and provides business information to the public (CCM, 2012).

Corporate governance mechanism can be divided into two major mechanisms: internal and external control. The main external control mechanisms are the market for corporate control, managerial labor markets and concentrated shareholding by block-holders. On another side, there are two essential internal corporate governance mechanisms; the director's shareholding and board of directors (BOD). Due to the weak market control, the internal corporate control mechanisms play a vital role in the corporate governance mechanism in the emerging economies (Ahmad & Seet, 2009).

Asian Financial Crises of 1997 put their marks on Malaysian firms as well, and it revealed the poor corporate governance practices in the country (Wahab et al., 2007). Most of the companies suffered from over-leveraging, allegations of cronyism and poor legal protection for investors against expropriation due to corporate insiders (Claessens et al., 2002). These issues became worst due to lack of corporate takeovers in Malaysia and politically connected firms in the country (Faccio & Lang, 2002).

Internal corporate governance mechanism is essential for successful corporate governance. Most of the Malaysian SMEs failed to follow the corporate governance rules. Due to this imbalance, many SMEs are involved in different sort of fraudulent activities, such as; lodgment of false and misleading particulars, illegal deposit taking, illegal investment schemes. The illegal investment schemes affect many investors and involved ahuge amount of money. Furthermore, according to the CCM that all companies registered under the CCM are required to submit their annual reports, annual returns, tabling accounts and conducting annual general meetings. In spite of that, most of the SMEs failed to follow these guidelines, and it was found that SMEs in Malaysia tend to submit misleading statements (CCM, 2012). Most of seen in inferior returns, weak growth, and poor stock market valuations (Bennedsen & Caspersen, 2007; Cronqvist & Nilsson, 2003;Maury, 2006).

According to(Tellez, 2009), in the emerging economies, most of the business belongs to certain business groups and families. Generally, decision making in such firms is controlled by majority shareholders, and they are liable for the consequences (Silva & Majluf, 2008). On the other side, the majority shareholders can enjoy the opportunity to expropriate the firm's resources for their own benefits. But it will affect the other shareholders (Shleifer & Vishny, 1997).

6. SMEs in Malaysia And its challenges and adaptability

Corporate governance failure within the SMEs is a big threat to Malaysian economy, as it is stated that SMEs are the major contributor to the country's GDP (Bank Negara Malaysia, 2006; NSDC, 206), and the major employment sector of the country (SME Corp Malaysia, 2012-13). Malaysian SMEs are the model of family-concentrated ownership (Claessens, Djankov, & Lang, 2000), and where ownership became more concentrated, chances for the protection of minority shareholders rights will be low (Silva & Majluf, 2008). In such type of firms, thefamily has the power of decision making, and also their relatives and close friends are being hired as the board of directors. Similarly, the top management positions are kept within the family (Oly Ndubisi et al., 2009) and such firms doesn't have good corporate governance practices (Himmelberg et al., 2004). Lack of competencies in the business owners and the lack of skills and expertise among the people holding the management position has caused the failure of the most SMEs (Silva & Majluf, 2008).

Most of the SMEs failed to follow the corporate governance reforms from CCM, and it caused many fraudulent activities, providing fake financial and annual reports, illegal investment schemes which lead to high monetary loss to the outside investors (R. N. Longenecker, 1999). Good corporate governance practices lead firms to good corporate performance; the failure of many SMEs is the result of poor corporate governance practice (Wahab et al., 2007). All these problems discussed here have an adverse effect on the corporate governance practices in the SMEs. Due to these problems, most of the SMEs fail, and the failure rate of Malaysian SMEs is quite high at 60 percent (Ahmad & Seet, 2009).

performance, taking managerial benefits such as spending profligately and corporate jets (Hussain, Yaakub, Ab Rahman, Zainol, & Kamal, 2010).

Mergers between affiliated companies that drain off resources out of the bidder or the target, ineffective cross-subsidization of investment among division, excessive diversification, targeted share repurchases, and diluted share issues that discriminate against minority shareholders are some methods of deceiving shareholders (Hussain et al., 2010). There have been accusations that, in Malaysian firms, majority shareholders enrich themselves at the shareholders' expenses through fake invoicing, force bailout, and mutualizing proceeds from capital raising exercise (Oly Ndubisi et al., 2009).

The expropriation of shareholders' rights formerly described as the misalignment of interests among shareholder groups or extensive ownership of cash flow rights. Expropriation leads to the majority management, isolation from external corporate control mechanisms, lavish salaries and dividends, or family members in the board of directors without required qualifications (Young, 2002). The likelihood for theexpropriation of shareholders' rights with the lower economic performance and inadequate investment opportunities in the area restrict the investment and interest of foreign investors, annoying the real low turnover on regional stock exchanges (Oly Ndubisi et al., 2009).

The reason for expropriation is that the family members are the majority shareholders of the firm and they can take resources out from the firm for their own good. As they have the power of being themajority shareholder in the firm (Shleifer & Vishny, 1997). Such kind of expropriation reduces the market value of the firm (Dahya, Dimitrov, & McConnell, 2008). Firms with majority shareholders involved in theexpropriation of shareholders rights do not perform well. There is anegative relationship between shareholders' expropriation and firm value (Aad et al., 2012; Dahya et al., 2008; Lins, 2003;Porta, Lopez-de-Silanes, & Shleifer, 1999).

Expropriation activities commenced by the family majority shareholders to enhance their personal utility cause the poor firm performance (Anderson & Reeb, 2003). This poor performance can be

57.4% in 2012. Compared with the previous year, the rate of employment increased significantly up to 6.5 % in 2012. Similarly, the employment rate in the year 2011 was also high compared to its previous year. It is shown that each year the numbers of employees are increasing in the SME sector (SME Corp Malaysia, 2012-13). SMEs have a higher contribution to the overall employment in comparison to the large sized firms (Table 1).

Table 1:
SMES, Large Firms and Total Employment (2009 – 2012)

	2009	2010	2011	2012	% share 2012
SMEs Employment	4,100,952	4,389,823	4,562,815	4,854,142	57,4%
Employment in large firms	2,800,097	3,294,714	3,403,549	3,606,829	42,6%
Total Employment	6,901,049	7,684,537	7,966,364	8,460,971	100%

Source: Department of Statistics, Malaysia

Most of the Malaysian SMEs are family owned. Particularly, 72% family owned firms exists in Malaysia and this is the situation in many developing countries. Similarly, 60% SMEs are family concentrated and they do not practice corporate governance well (Himmelberg, Hubbard, & Love, 2004). Mostly the families have control over themanagement of the firms (Claessens, Djankov, Fan, & Lang, 2002; Galis & Khatri, 2002). According to (Ibrahim & Samad, 2011), family concentration in Malaysian firms increased from 57.7% to 67.2% and the cutoff level for voting has increased from 10% to 20%. They further expressed that, the Malaysian SMEs structure reflects concentrated ownership and high agency cost due to fraudulent behavior of the majority shareholders.

5.Confiscation of shareholders rights

Confiscation of minority shareholders rights occurs when the majority shareholders take profit of the firms for themselves rather than to return it to the minority shareholders. This means that the control shareholders can make private benefits at the shareholders' expense. It consists of misappropriation, resisting potentially beneficial takeover offers, selling and buying assets without shareholders' consent. Furthermore, related lending, diverting corporate opportunities from the company, hiring unqualified family members on managerial positions, rewarding themselves with undue pay without following statements in relation to its compliance with the Malaysian Code on Corporate Governance in its annual report:

(i) A narrative statement of how the listed issuer has applied the principles set out in Part 1 of the Malaysian Code on Corporate Governance to their particular circumstances; and

(ii) A statement on the extent of compliance with the Best Practices in Corporate Governance set out in Part 2 of the Malaysian Code on Corporate Governance which statement shall specifically identify and give reasons for any areas of non-compliance with Part 2 and the alternatives to the Best Practices adopted by the listed issuer, if any. The requirement was aimed towards regulating companies to be more transparent and accountable in their actions in order to gain investors' confidence. It is hoped that this would reduce the effects of the agency theory and signaling theory, thus paving the way for a more efficient capital market. Indirectly, it also envisaged that these efforts would, in turn, boost the country's economic growth as well as encouraging inflow of foreign direct investments. In other words, good corporate governance is the key to a robust and competitive corporate sector, which serves as a source for sustainable economic growth.

4.Overview on SMEs in Malaysia

Small and medium enterprises (SMEs) have a major contribution to the Malaysian economy, it represents 65% of the total employment in the labor market and 99.2% of the overall SMEs business establishments in Malaysia and (Bank Negara Malaysia, 2006). Malaysian SMEs contribute 32% of the GDP and 19% of the total export value of the SMEs' (NSDC, 206). The contribution of the export value is below the average line compared with the other Asian countries, which is more than 50% (Ndubisi, Malhotra, & Wah, 2008). The Malaysian government is taking several initiatives to promote SMEs in the country to achieve high contribution from SMEs in the economy. Such as, ICT growth for SME'sknowledge-based development and the ninth Malaysia plan, effective from 2006 to 2010. The reason is to encourage and empower the growth and establishment of the SMEs in the country (Oly Ndubisi, Rachagan, & Satkunasingam, 2009). It's been discussed since decades that SMEs are the major components in the economic growth of any country. Similarly, SMEs are the major source of employment in many developed and emerging markets. So far in Malaysia, SMEs are the major contributors towards the overall employment by contributing

Elements of corporate governance that are recommended by the master plan would include promoting shareholders' and consumers' activisms, regulatory control and priority sector financing. Some of the specific recommendations to the banking sector indicated the requirement of having board committees to further improve corporate governance, the implementation of a transparent and clearly structured early warning system for weak banking institutions, encourage mergers between banking institutions and establish a deposit insurance funds.

3.4 Institutional Development

The development of corporate governance in Malaysia is also complemented by the institutional development. The establishment includes the Malaysian Institute of Corporate Governance (MICG) and the Minority Shareholders Watchdog Group (MSWG).

The Inception of Malaysian Institute of Corporate Governance (MICG)

MICG was established in March 1998 by the High-Level Finance Committee on Corporate Governance. It is a non-profit public company limited by guarantee, with founding members consisting of the Federation of Public Listed Companies (FPLC), Malaysian institute of

Accountants (MIA), Malaysian Association of Certified Public Accountants (MICPA),

Malaysian institute of Chartered Secretaries and Administrators (MAICSA), and Malaysian Institute of Directors (MID). MICG's mandate was to raise the awareness and practice of good corporate governance in Malaysia. MICG was given a start-up capital of RM50, 000 and later in 1999 was given a contribution of RM79, 000 from the Registrar of Companies. Other than these monies, MICG had been operating on revenues from its programmes and private donations ever since. MICG usually runs a balanced budget every year, thus there are usually very little surplus funds to bring forward to the next year.

The Report on Corporate Governance published by the High-Level Finance Committee on March 1999 has stipulated MICG as 'The Recognized Corporate Governance Training Centre' (CGTC). Bursa Malaysia Berhad (formerly known as Kuala Lumpur Stock Exchange) also partake in the effort of enhancing corporate governance in Malaysia by revamping its' Listing Requirements. For instance, Chapter 15 of the Revamped Listing Requirements address issues on corporate governance and one of the paramount requirements spells out that a listed issuer must ensure that its board of directors makes the

3.1 Malaysian Code on Corporate Governance

The initiative started with the establishment of Finance Committee on Corporate Governance in 1998 that consists of both government and industry. Recognition of corporate governance in

Malaysia was significantly evidenced by the released of the Malaysian Code on Corporate

Governance by the Committee in March 2000. The principles underlying the report focus on four areas including board of directors, director's remuneration, shareholders and accountability and audit. The code is hybrid in nature, which is similar to the Combined Code on Corporate Governance (United Kingdom). Under the approach, the companies in Malaysia should apply the broad principles of good corporate governance sets out by the code flexibly and with common sense to the varying circumstances of individual companies.

3.2 Capital Market Master Plan (CMP)

Complementing the reforms is the introduction of Capital Market Master Plan by the Securities Commission to chart the direction of the Malaysian capital market for the next ten years. It was initially announced by the Second Finance Minister and Chairman of Securities Commission on August 6, 1999, and subsequently approved by the Minister of Finance in December 2000 before it's launching in February 2001. The efficient mobilization and allocation of funds together with thehigh degree of confidence to market participants are the visions outlined by the CMP. Corporate governance is a key strategic thrust of the CMP as the Securities Commission considers good corporate governance among public listed companies is vital to achieving the objective of promoting a more conducive environment for investors in the Malaysian capital market. One of the recommendations by the CMP is a mandatory disclosure on the state of compliance with the

Malaysian Code on Corporate Governance which was issued in the revamped exchange listing requirements on January 22, 2001, to listed companies.

3.3 Financial Sector Master Plan (FSMP)

Financial Sector Master Plan (FSMP) was launched in March 2001 by the Bank Negara Malaysia to chart the future direction of the financial sector over the next ten years. It has the objective of developing a more resilient, competitive and dynamic financial systems that contribute to the economic growth and technology driven.

2.The role of Corporate Governance

A definition by the Finance Committee on Corporate Governance in Malaysia in the Report on Corporate Governance (2002) stated that: "Corporate governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking account the interests of other stakeholders". This indicates that corporate governance is not only applied to the shareholders but the other stakeholders as well.

From the economic perspective, corporate governance is an important element of achieving an locative efficiency in which scarce funds are moved to investment project with the highest returns. In practice, efficiency is achieved when at given level of risk, investments project offers the highest return exceeding its cost of capital. The crisis indicated how the failure to regulate good governance affected the mobilization of funds in an effective way. Corporate finance, on the other hand, concerns on the effectiveness of corporate governance as an assurance in protecting the invested funds and to generate returns. As highlighted by (Rajgopal & Venkatachalam, 1997) corporate governance mechanisms assure investor in organizations that they will receive adequate returns on their investments. To relate this to the crisis, it is concluded that efforts on shareholders protection were inadequate during the crisis and as such contributed to the destruction of the value of their investment.

3. The history of Corporate Governance in Malaysia

The main sources of the Corporate Governance reforms agenda in Malaysia are from the

Malaysian Code on Corporate Governance by Finance Committee on Corporate Governance,

Capital Market Master Plan (CMP) by Securities Commission and Financial Sector Master Plan (FSMP) by Bank Negara Malaysia on the financial sector. It provides guidelines on the principles and best practices in corporate governance and the direction for the implementation as well as charts the future prospects of corporate governance in Malaysia.

sharply due to high-interest rates and in acrisis environment. Banks, which had a significant portion of their loan exposure in the construction and real estate sector; and stock purchase financing, were badly affected.

There were different views on the causes of the crisis. Some viewed that the direct reason for the financial crisis was attributed to a downturn in the economy, the collapse of the property and stock markets. However, the more fundamental reasons were state-directed loan policies, lack of competition and lack of prudential regulations. Another view indicated the significant impact of too much exposure of the banking institutions on debts to accommodate the economic boom in the early 1990s as a source of the crisis.

(Krugman, 1999) in "What Happened to Asia" and (Corsetti, Pesenti, & Roubini, 1999) in "What Caused theAsian Currency and Financial Crisis" advocated the 'Fundamentalists View' pertaining to the crisis. They argued that the crisis was due to structural weaknesses in the domestic financial institutions supported by unsound macroeconomic policy and moral hazard.

The World Bank (1998) regarded the vulnerability in the banking sector was attributed to poor risk management and excessive lending. Poor risk management was reflected by weak corporate governance and limited investment in risk management technology. The excessive lending was caused mainly by extensive cross-ownership of banks and companies, weak enforcement of bank regulations and government-directed lending. Combining these two categories resulted to thelarge amount of non-performing loans and insolvent financial institutions that subsequently had to be financially supported, merged or liquidated.

Even though various factors were highlighted to explain the causes, there was a consensus among the above-mentioned ideas that the element of poor governance could not be separated in explaining the crisis. As such, like other economies in East Asia, corporate governance has been actively promoted to the Malaysian corporate sector in a period of the crisis. Measures have been taken to improve the aspects of fairness, transparency, accountability and responsibility in running the organizations.

In Malaysia, expropriation of the minority shareholders rights mostly occurs in the firms with concentrated ownership. Most of the majority shareholders found involved in such kind of activities.

Malaysian SMEs experience toward effective corporate governanceb Adaptability and Challenges

Dr.Lahcene Makhloufi - Dr. Bader Ayed Al-Qaied

Abstract:

Currently, SMEs are recognized as a crucial impact on economic growth in both developed and the developing economies. SMEs are the backbone contributor to the GDP and employment in everywhere the world. Today, the corporate governance practices it is critical for thecompany and it is essential to be implemented in order to monitor and control firms. The ownership focusing in Malaysian SMEs has resulted in less protection of the minority shareholders. This is because; most of the companies are family based, where the family members hold the top management positions. Thus, the majority shareholders are involved in the act of expropriation, which results in loss of huge amount of money and trust of the minority shareholders. SMEs in Malaysia does not have any documented corporate governance code, this led to many problems like confiscation. This paper is investigated on themedium sized company. Moreover, this research discusses the extent of confiscation of minority shareholders and the need to have an overall code to monitor the firms and control the stakeholders, and as well it assists to keep the minority shareholders' rights.

Keywords: SMEs, shareholders, corporate governance, Confiscation.

1.Introduction:

The debate on Corporate Governance in Malaysia as well as other East Asian countries should be initiated from the event of East Asian economies collapsed in the second half of 1997.

The period placed a greater concern and recognition of Corporate Governance to the public and private sector in those countries.

The financial crisis was triggered in Thailand when foreign investors lost their confidence and started to withdraw capital due to currency devaluation. The problems transmitted to other neighboring countries. The most affected countries included Indonesia, Malaysia, South Korea, and the Philippines. In Malaysia, attempts to contain further devaluation caused ahigher level of interest rate and credit contraction. This created severe contractions in output and corporate profitability which was reflected in massive fall of equity prices. The Kuala Lumpur Composite Index declined by 72% during the period from end-June 1997 to end-August 1998. Real estate markets declined