

**Impact of corporate governance board structure on financial performance of
Chinese controlled public listed companies in Malaysia**

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Abstract

Corporate Governance gained prominence in Malaysia during the Asian financial crisis of 1997. Kuala Lumpur Stock Exchange issued the Listing Requirements on 22 January 2001 to regain investors' confidence and attract foreign direct investments. The Listing Requirements included a Code of Best Practices in Corporate Governance that prescribes an effective board structure to be adopted on a voluntary basis by companies. The Code favours the separation of chairman/CEO posts (*separate titles*) and the appointment of at least one-third Independent Non-Executive Directors to the board (*board independence*). In Malaysia, Chinese controlled businesses continue to play a significant role to the domestic economy in employment creation and GDP contribution. Hence, Chinese business culture has a positive impact to the implementation of the Code to companies. The literature reveals that the adoption of the prescribed board structure is not likely to improve the financial performance of Chinese controlled companies, because these companies practise a distinctive Chinese business culture. An empirical research study is conducted, using 218 Chinese controlled public listed companies in Malaysia. The data covers the three years from 2001 to 2003. The independent variables of board structure are separate chairman/CEO titles, one third Independent Non-Executive Directors, and strong board where both separate titles and board independence are present. Financial performances of the companies are measured by ROE, EPS, DPS, liquid asset/share and gross margin. The results show that there has been widespread adoption of the board structure recommended under the Code by the sample companies. The results also show that adoption of the prescribed board structure under the Code, both separate titles and board independence, has no significant impact on the financial performance of the sample companies.

Key words: Corporate governance, separate chairman/CEO titles, independent directors, Chinese business culture.

Chinese business culture

The combined Chinese population in Malaysia, Indonesia, Philippines, and Thailand is approximately 6 percent, but they control about 70 percent of the region's wealth (Backman, 2004). Doing business in Asia inevitably means dealing with the Asian Chinese and the Asian Chinese business culture. The Chinese have a distinctive culture in running their businesses. They operate their enterprises as family companies (Backman & Butler, 2003). The company is synonymous with family. The family is synonymous with the recognition of the anointed leader as the patriarch (Yeung & Soh, 2000). In addition to family members, the leader uses people he can trust in key positions, and relies on networks to do business (Zang, 1999). These loyal workers are rewarded with seats on the board. They act and make decisions with tacit blessing from the leader (Yu, 2001).

Practices in corporate governance and its likely impact on financial performance of Chinese controlled public listed companies in Malaysia

Bursa Malaysia Listing Requirements of 2001 brought into effect the Malaysian Code on Corporate Governance. The Code includes a chapter on Best Practices in Corporate Governance to regulate the practice of corporate governance by companies. Part AA II of the Code states that there should be a clear division of responsibilities between the chairman and CEO. This will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Part AA III of the Code states that an effective board should be made up of at least one-third Independent Non-Executive Directors. These directors should be persons of calibre, credibility and possess the necessary skill and experience to bring independent judgments on issues of strategy and performance.

The Code supports and prescribes **separate titles**. However, for Chinese businesses, unitary leadership structure is often indispensable. The owner of a public listed company is often the founder. He is akin to the brand name of the company. While the corporate sector in the west is a community of companies, the business community in Asia is a community of personalities (Backman, 2004). When China Cyberport in Hong Kong

bought a stake in Kerry Group, the big news was that Indonesian tycoon Oei Hong Leong had bought a stake in the company owned by Malaysian tycoon Robert Kuok (Backman & Butler, 2003). It is thus inconceivable in the filial minds of family members, workers, suppliers and customers that the founder does not occupy the top positions in the board and management.

One of the strengths of Chinese businesses is the speed of decision making that is centralized in the leader (Li, Khatri & Lam, 1999). The founder often unilaterally makes business decisions, and seeks board endorsements subsequently (Yueng & Soh, 2000). A unitary leadership structure becomes important, because it offers a clear mandate to a single leader to react faster to external events (Fan, Lau & Wu, 2002).

The founders of Chinese listed companies often have little formal education (Kim, Kandemir & Cavusgil, 2004). Their decision making process is thus different from western models. They draw from their experiences, advice from trusted friends developed through *xinyong* (trust), and their intuitive perception of the situations (Haley, 1997). Board deliberations before decisions are an archaic concept to them. They assume positions of chairman and CEO to preserve the powers to decide within the corporate structure.

The Code also supports the appointment of at least one-third **Independent Non-Executive Directors** on the board. Malaysia Listing Requirements emphasises on two key elements of independence for the Independent Non-Executive Directors; namely, independence from management and CEO, and independence from the controlling/substantial shareholders. The duties of Independent Non-Executive Directors are carried out as a principle of good corporate governance, and not legislated by law (Cheah, 2003). Most of the Independent Non-Executive Directors in Malaysia are professionals, like lawyers and accountants, although no minimum qualification is required for those who accepted appointments (Low, Yong & Shanmugam, 2004). The appointment of Independent Non-Executive Directors is usually initiated by the major shareholders who are also the board chairman or CEO of the public listed company.

Hence, these appointees are morally obliged to the executive directors for resolutions whether made in board meetings or general meetings (Koh, 2003).

In Chinese controlled companies, Independent Non-Executive Directors are rarely independent. They are normally appointed through close ties with the owners, or senior managers (Low, 2003). No stranger is appointed to the board. Directors are appointed in recognition of their loyal service or friendship. Their appointment is symbolic of the entrepreneur's trust in them, and not necessarily a proclamation of their competence (Backman, 2001). Independent Non-Executive Directors are appointed to the board according to the Chinese entrepreneur's own definition of independence (Low, 2003). These Independent Non-Executive Directors often sit on the board as a mere obligation to the entrepreneur, and for loyalty vote in the event of a countdown (Tong & Yong, 1998).

Since Independent Non-Executive Directors are not truly independent in Chinese controlled companies, they cannot be expected to carry out the monitoring function effectively. Thus, their presence on the board is unlikely to improve financial performance of the company. When it comes to making critical decisions involving a potential conflict of interest between the majority and minority shareholders, Independent Non-Executive Directors are likely to support the former. This is especially so in Malaysia when annual general meetings are usually poorly attended, and resolutions are passed with hardly any debate (Low, Yong & Shanmugam, 2004).

It is perceived that a company that adopts the prescribed board structure will enjoy improved monitoring ability and accountability, which will then lead to improved financial performance (Abdullah, 2004). This is possible because management abuses will be curtailed. It means that a company that splits the positions of chairman and CEO, or appoints at least one-third Independent Non-Executive Directors to the board, or both, will enjoy improved financial performance. There is thus a perceived association between board structure and financial performance of a company. Because of the high economic influence of Chinese in Malaysia (Ward, Pearson & Entekin, 2002), it becomes

necessary to test the said perceived association in one demographic condition – the Chinese business cultural environment.

The link of separate titles to financial performance of companies produces mixed results. Some authors find that separation of board chair and CEO has no significant impact on financial performance of companies (Daily et al., 2002; Fan, Lau & Wu, 2002; Elloumi & Gueyie, 2001; Weir & Laing, 2001; Daily & Dalton, 1997). However, Brickley, Coles & Jarrell (1997) find that companies with separate titles consistently outperform companies with combined titles. Then Simpson and Gleason (1999) find that the combined titles may positively influence the internal control system of a banking company, and improve financial performance. Overall, there is no compelling empirical support for the view that separate titles have a positive impact on financial performance of companies.

The link of one-third independent board representation on the board to financial performance of companies again produces mixed results. Some studies fail to find any relationship between the presence of Independent Non-Executive Directors on the board and financial performance of the company (Barrat & Korac-Kakabadse, 2002; Fan, Lau & Wu, 2002; Vafeas & Theodoros, 1998). Independent Non-Executive Directors may just be appointed to the board in order to comply with the best practices, and may not necessarily lead to improved financial performance (Peng, 2004).

Hypotheses

The literature and theoretical arguments are that the prescribed board structure (separate titles/board independence) in the Code is not receptive to the Chinese entrepreneurs, who may adopt the same in form but not in substance. The adoption of the prescribed board structure is, therefore, unlikely to have an impact on the financial performance of Chinese controlled public listed companies in Malaysia. In the premises, the following hypotheses are framed:

H1: The separation of chairman and CEO positions **alone** is not likely to improve the financial performance of Chinese controlled public listed companies in Malaysia.

H2: The appointment of at least one-third Independent Non-Executive Directors to the board of directors **alone** is not likely to improve the financial performance of Chinese controlled public listed companies in Malaysia.

H3: The separation of chairman and CEO positions **and** the appointment of at least one-third Independent Non-Executive Directors to the board of directors **together** are not likely to **further** improve the financial performance of Chinese controlled public listed companies in Malaysia.

Sample

The sample consists of 218 Chinese controlled public companies listed on the main board of Bursa Malaysia. These sample companies cover all sectors of the industry, except the financial and insurance companies which are separately regulated. There are PN4 companies that seek protection of the court from creditors while going through the corporate restructure. These PN4 companies are excluded for the purpose of this research.

The Code was issued on 22 January 2001. The impact of board structure prescription on financial performance *after* the introduction of the Code is assessed. Data is collected for the three years from 2001 to 2003. The research focuses on matured companies to ensure that financial data is stable. Arbitrarily, public listed companies that are established at least five years before 2001 are considered mature. That means companies which are listed on and before 1996 will be included in the sample.

There are a few indicators whether a public listed company in Malaysia is controlled by Chinese. The shareholdings are the clearest indicators. Chinese control is manifested when they are the single biggest shareholder or major shareholder in the company. They are also able to control the company through the management as the CEO/MD. At the board level, the Chinese entrepreneurs usually control the company by occupying the executive chair, or by letting a bumiputra to occupy the non-executive chair. The Chinese entrepreneurs may also exercise control in the company by having a majority of Chinese board members.

Analysis

Table 1 shows the descriptive statistics that is used to gain an understanding of the characteristics of the sample for the three years 2001, 2002 and 2003. Table 2 shows the results of the t-test. Table 3 shows the Spearman's rho correlation analysis for all the variables that are involved in the study.

Table 1 Descriptive statistics

	2001			2002			2003		
	Minimum	Maximum	Mean	Minimum	Maximum	Mean	Minimum	Maximum	Mean
Duality	0	1	0.11	0	1	0.09	0	1	0.09
INED1	1.00	6.00	2.7569	1.00	6.00	2.9862	1.00	6.00	3.0917
INED2 (%)	9.09	85.71	35.5253	11.11	83.33	38.6035	20.00	83.33	40.1067
INED3	0	1	0.69	0	1	0.83	0	1	0.83
Strong Board	0	1	0.61	0	1	0.75	0	1	0.74
ROE (%)	-447.36	65.74	-6.4581	-487.42	42.19	-2.3041	-544.16	319.99	2.5120
EPS	-272.00	238.00	2.9903	-273.00	566.00	9.3406	-47.20	782.00	16.1450
DPS	0	101.00	5.3101	0	171.00	5.2555	0	115.00	5.5000
Liquid Asset/share	0	44.56	0.7178	0	49.89	0.7646	0	55.52	0.8087
Gross margin (%)	-75.55	100.00	28.3051	-18.49	100.00	29.2276	-114.72	100.00	29.5435

Duality = Chairman and CEO combined posts

INED1 = Number of Independent Non-Executive Directors

INED2 (%) = Percentage of Independent Non-Executive Directors

INED3 = at least one-third Independent Non-Executive Directors on the boards

Strong Board = separate titles and at least one-third Independent Non-Executive Directors on the boards

ROE (%) = return on equity

EPS = earnings per share

DPS = dividend per share

Table 2 Results from t-test

Test variable	Mean differences			t-values		
	2001	2002	2003	2001	2002	2003
Separate titles						
ROE (%)	9.07433	-3.18451	-5.32561	0.704	-0.334	-0.479
EPS	-0.34906	-6.57670	-11.28530	-0.036	-0.505	-0.753
DPS	-1.31880	-1.75116	-0.48444	-0.496	-0.512	-0.918
Liquid Asset/share	-0.28500	-0.33485	-0.50175	-0.405	-0.400	-0.539
Gross margin (%)	0.26278	0.11794	-0.53452	0.061	-0.026	-0.103
Board Independence						
ROE (%)	0.20761	-7.02040	-3.33969	0.024	-0.958*	-0.395*
EPS	-2.83441	-9.05520	1.29690	-0.444	-0.915	0.114
DPS	3.47120	3.01474	3.32099	1.985**	1.161	1.796**
Liquid Asset/share	0.57799	-0.30775	-0.24449	1.243	-0.483	-0.345
Gross margin (%)	-3.52260	-2.04815	-1.88649	1.246	-0.597	-0.491

Strong board							
ROE (%)	3.81798	-5.28704	-4.93072	0.471	-0.830*	-0.675*	
EPS	-2.84068	-9.32857	-3.63125	-0.468**	-1.080	-0.369	
DPS	2.65808	1.70089	2.39688	1.595**	0.748	1.498**	
Liquid Asset/share	0.43215	-0.38699	-0.38024	0.976	-0.696	-0.622	
Gross margin (%)	-1.94644	-2.21519	-1.88591	-0.723	-0.734*	-0.565*	

** Significant at the 0.01 level (2-tailed).

* Significant at the 0.05 level (2-tailed).

Separate Titles = Separate chairman and CEO positions

Board Independence = at least one-third Independent Non-Executive Directors on the boards

Strong Board = separate titles and at least one-third Independent Non-Executive Directors on the boards

ROE = return on equity

EPS = earnings per share

DPS = dividend per share

Table 3 Spearman's rho correlation analysis

Variable	Separate Titles	Board Independence	Strong Board	ROE	EPS	DPS	Liquid Asset/Share	Gross margin (%)
2001								
Separate Titles	1.000	-0.038	0.430*	0.001	-0.019	0.004	-0.004	-0.057
Board Independence	-0.038	1.000	0.842*	-0.019	-0.029	-0.057	-0.069	0.066
Strong Board	0.430**	0.842**	1.000	-0.044	-0.033	-0.051	-0.071	0.011
ROE (%)	0.001	-0.019	-0.044	1.000	0.808**	0.510**	0.368**	-0.018
EPS	-0.019	-0.029	-0.033	0.808**	1.000	0.697**	0.431**	0.092
DPS	0.004	-0.057	-0.051	0.510**	0.697**	1.000	0.460**	0.068
Liquid Asset/Share	-0.004	-0.069	-0.071	0.368**	0.431**	0.460**	1.000	-0.038
Gross margin (%)	-0.057	0.066	0.011	-0.018	0.092	0.068	-0.038	1.000
2002								
Separate Titles	1.000	-0.020	0.547*	0.021	0.033	0.006	-0.011	-0.034
Board Independence	-0.020	1.000	0.791*	-0.148*	-0.077	-0.121	-0.133	0.015
Strong Board	0.547**	0.791**	1.000	-0.131	-0.046	-0.100	-0.105	0.014
ROE (%)	0.021	-0.148*	-0.131	1.000	0.820**	0.521**	0.399**	0.182**
EPS	0.033	-0.077	-0.046	0.820**	1.000	0.683**	0.431**	0.176**
DPS	0.006	-0.121	-0.100	0.521**	0.683**	1.000	0.509**	0.068
Liquid Asset/Share	-0.011	-0.133	-0.105	0.399**	0.431**	0.509**	1.000	0.019
Gross margin (%)	-0.034	0.015	0.014	0.182**	0.176**	0.068	0.019	1.000
2003								
Separate Titles	1.000	-0.104	0.534*	0.117	0.096	0.089	0.026	-0.014

Board Independence	-0.104	1.000	0.772* *	-0.156*	-0.097	-0.105	-0.122	0.027
Strong Board	0.534**	0.772**	1.000	-0.052	-0.024	-0.044	-0.101	0.023
ROE (%)	0.117	-0.156*	-0.052	1.000	0.764**	0.562**	0.417**	0.174*
EPS	0.096	-0.097	-0.024	0.764**	1.000	0.771**	0.456**	0.161*
DPS	0.089	-0.105	-0.044	0.562**	0.771**	1.000	0.494**	0.134*
Liquid Asset/Share	0.026	-0.122	-0.101	0.417**	0.456**	0.494**	1.000	0.110
Gross margin (%)	-0.014	0.027	0.023	0.174*	0.161*	0.134*	0.110	1.000

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

Separate Titles = Separate chairman and CEO positions

Board Independence = at least one-third Independent Non-Executive Directors on the boards

Strong Board = separate titles and at least one-third Independent Non-Executive Directors on the boards

ROE = return on equity

EPS = earnings per share

DPS = dividend per share

Summary and limitations

This paper has analysed the extent of compliance by Chinese controlled public listed companies in Malaysia with the prescribed board structure under the said Listing Requirements. The results show that there has been widespread adoption of the board structure recommended under the Code by Chinese controlled public listed companies. These companies have adopted the separate-titles leadership structure prescribed in the Listing Requirements, with only less than 10 percent of the companies exhibiting combined titles by the year 2003. Generally, the Chinese entrepreneurs have embraced board independence as a governance practice. There is an increase from 69 percent in 2001 to 83 percent in 2003 of boards having at least one-third Independent Non-Executive Directors.

The study finds no association between separate-titles leadership structure and financial performance of Chinese controlled public listed companies. The findings are not unexpected. In line with the Chinese business culture, the Chinese entrepreneurs of these companies will run the companies in their own distinctive monopolistic nature. These Chinese businessmen started off by holding the combined posts of board chairman and CEO to ensure business efficacy. When the Listing Requirements were introduced in 2001, the study finds that most of these companies began separating the positions of

chairman and CEO. The Chinese entrepreneurs themselves tend to hold the board chair. The CEO positions are delegated to their trusted people. The CEO carries out his tasks with the tacit blessing of the chairman. The unwritten rule is that the CEO will act within his confines, and will not act in ways that may invite the wrath of the chairman. Hence, the type of leadership structure, whether separate or combined titles, has no significant effect on how the Chinese controlled public listed companies perform financially.

The study also finds no association between the appointment of at least one-third Independent Non-Executive Directors on the boards and financial performance of Chinese controlled public listed companies. The findings are as expected. In line with the Chinese business culture, the Chinese entrepreneurs of these companies will appoint their trusted persons to become Independent Non-Executive Directors. These independent directors will not be expected to perform effective monitoring functions. Instead, they will be expected to support policy matters advocated by the Chinese entrepreneurs. Dissent is perceived as disloyalty (Navaratnam & Siva, 2003).

The study has a number of limitations that paves the way for further research. The study encompasses data of Chinese controlled public listed companies in Malaysia only. The results of the study should not be generalised across national boundaries, because of demographic and environmental differences (Soederberg, 2003). Good governance is an adaptive process that caters to the specific circumstances of each country (Lu & Batten, 2001), and cannot fit into established templates (Letza, Sun & Kirkbride, 2004). Generally, empirical research appears to examine governance variables in a univariate context. When the board structure is studied in an isolated context for causal effect, the findings have a confounding effect, and are usually not generalisable (Coles, McWilliams & Sen, 2001).

Board effectiveness also depends on the individual skill of the board members, and whether they can work together as a team. The extraneous variables may well be the number of directorship that the directors hold, whether they possess any special skill or knowledge that can bring value added benefits to the company, their relationship to

chairman or CEO, their character. It is possible that any one of these extraneous factors is the very essence that affects financial performance, and yet is not captured in the study.

This paper did not use interviews or case studies to examine in depth a few companies to obtain an insight into decision making process in the choice of board structure. The research can perhaps be more meaningful by complementing it with an ethnographic study on the directors. However, there will be the inevitable problem of access and whether board members are willing to cooperate. Chinese controlled public listed companies in Malaysia do not readily welcome interviews or studies into the boardroom affairs. It is surmised that the effectiveness of boards cannot be determined by mere board configuration, and the results of any quantitative study are bound to be equivocal.

Further research

This dissertation presents opportunities for integrative research into areas of Chinese business culture, and corporate governance. In emerging markets like Malaysia, the founders of most public listed companies are aging. Their siblings trained in western values are taking over (Backman & Butler, 2003). As the second generation of Chinese business leaders is equipped with western values, a transformation is taking place (Li, Khatri & Lam, 1999). *Xinyong* (trust) is losing ground, and replaced by systems trust whereby one's word is no longer good enough, and the negotiating party needs to examine the paid up capital of the company (Tong & Yong, 1998). This new generation of Chinese leaders of listed companies in Malaysia is driven by shareholders' value creation and high accountability to the stakeholders within the companies. These western values could co-exist with the traditional value of family wealth creation of the second generation of Chinese business leaders who are also the major shareholders. The Malaysia Code of Corporate Governance could, thus, be more receptive to this new generation of corporate players.

The Listing Requirements spells out what or whom an Independent Non-Executive Director ought not to be in the selection criteria. The selection process is left to the

wisdom of the board (Ow-Yong & Cheah, 2000). There is no scrutiny by Bursa Malaysia. Mere compliance with the Code is unlikely to contribute to financial performance of companies and to regain investor's confidence, where the majority of Chinese controlled companies continue to practise their business culture in the selection of connected persons as Independent Non-Executive Directors. The situation could undergo a change in the future if the nomination of independent directors is done independently and has the involvement of representatives from the minority shareholders. This could then attract the right talents from members of professional bodies to contribute their broad based professional knowledge, skills and experience to enhance the competency and independence of non-executive directors.

Conclusion

The results of the empirical study are that the prescribed board structure under the Code, both separate titles and board independence, has no significant impact on the financial performance of Chinese controlled public listed companies in Malaysia. Even though there has been widespread adoption of the board structure recommended under the Code by Chinese controlled public listed companies, it suggests a mere symbolic move in governance compliance by these companies, rather than a substantive move to improve financial performance.

It is acknowledged that good corporate governance practices are essential to protect shareholders, and to instil investors' confidence. However, from the results of the empirical study in this paper, the Code is not likely to be successfully assimilated into the Chinese business culture. Most Chinese controlled public listed companies in Malaysia are not characterised by widely dispersed ownership under the agency theory framework, but by family control (Claessens, Djankov & Lang, 2000). These companies evolve from traditional family owned enterprises, and they do not see the need to embrace more openness in business practices (Ow-Yong & Cheah, 2000).

However, the route to corporate governance is, perhaps, inevitable. Following the Asian crisis, CalPERS draws up a set of global governance principles to ensure that the funds it commits to Asia are not invested in companies that lack corporate governance (Mitton, 2002). CalPERS requests that its profile of invested companies be composed of predominantly Independent Non-Executive Directors (Daily, Dalton & Cannella, 2003), and it publicly names companies that exhibit poor corporate governance practices (Wu, 2004). CalPERS, in fact, pulled out investments in Malaysia, Indonesia, Thailand, and Philippines in February 2002, citing concerns over corporate governance (Lyngaas, 2002).

As long as the managers are in charge of public funds, there is the need for corporate governance to mitigate manager-shareholder conflict (Vafeas & Theodorou, 1998). However, there is no universal prescription applicable to all economies. It is one thing to blame the Asian crisis on lack of good governance, and quite another to impose the western model of corporate governance that runs against the Chinese business culture. Asian values are still important as they stress the importance of harmony, while the western values place heavy emphasis on freedom and individualism (Kotler & Kartajaya, 2000). What Asia needs is a hybrid: the best of East and West.

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