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Exploring the Motives of Appointing Independent Directors

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Abstract

The aim of this study is to examine the views of chairman and members of nomination committee on motives in appointing an independent director in Malaysian public listed companies. Semi-structured interview was used and 21 directors were interviewed. The results indicate that independent directors were expected to execute their monitoring role, exercise unbiased judgment in questioning decisions made and safeguard balance of power between the board and management. In addition, the respondents believe that independent director should utilize their capacity from related background, expertise and experience in board meeting discussion in addressing issues or risks and making relevant suggestions.

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1. Introduction

Massive collapses of major corporations around the world have been paying attention on the role and effectiveness of the independent directors in public listed companies (PLCs). Fama and Jensen (1983) asserted that independent directors play a significant role in the board as they are experts with relevant skills in their respective fields. A board becomes a powerful and effective governance mechanism with expertise, legal power, and independence (Abdullah, 2013; Annuar, 2012; Byrd and Hickman, 1992). Therefore, board may enhance their performance by bring in independent directors to work with executives. This is because executive directors have companies inside information and they know their business activities better while independent directors may assist them through their business expertise (Beasley, 1996; Byrd and Hickman, 1992; Fama and Jensen, 1983). Annuar (2012) remarked that hiring independent directors are vital in improving board performance and effectiveness. Furthermore, Fama and Jensen

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(1983) explained most of the independent directors have huge experience in their professional area or they are in the top management in other companies or working as a decision agents in other organizations. Due to that, they can sit in a board as independent director to contribute competently.

Much work in the area of board studies conducted on issues such as board composition, presence of board committees, proportion of outside directors and roles performed by board, and their link if any to organizational performance (Kamardin and Haron, 2011). Findings from other studies are based on views of the independent directors and stakeholders whilst this study focuses on perceptions from the chairman and member of the nomination committee, key person that involved in selection and annual assessment process. Motivation of the study is driven by lack of studies focusing on motive of appointing independent directors and what role(s) is expected to be performed by the independent directors upon its appointment to the board. Thus, objective of this study is to examine the motives of appointing independent directors on the board based on the perspective chairman and members of nomination committee.

This paper begins with a discussion with changes on corporate governance in Malaysia and followed by prior literature on role of independent directors. Next section elaborates on research method used in the study and final section elaborates the findings and discussion on motives of appointing independent directors in Malaysian public listed companies.

2. Corporate governance in Malaysia

Corporate governance in Malaysia is largely influenced by the ownership patterns, which is closely held in nature. Majority of the listed firms in Malaysia are controlled by families. Being the largest shareholders, these families also appoint the CEO among the family members and have controlled over the appointment of the independent directors. Apart from that, government ownership is another important ownership feature in Malaysia. Hence, these two types of ownerships have resulted Malaysia listed firms being mostly closely-held firms. In addition, majority of the board chairman in Malaysian listed companies are non-independent and related to the largest shareholders (Abdullah, 2013). In this situation, the protection of minority shareholders interest is crucial (Haniffa and Hudaib, 2006). Independent director in closed control ownership should be an effective monitoring mechanism over minority interest and non-independent chairman. In relation to that, it is crucial to further explore whether the intention of appointing independent directors is merely to conform the listings requirement or expecting them to perform.

MCCG marked significant milestone in introducing good governance practices in Malaysia. MCCG first issued in 2000 emphasizes the importance of non-executive directors to bring an independent judgment on issues of strategy, performance and resources. The MCCG was later revised in 2007 with more focus to strengthen the role and responsibilities of board committee (i.e. audit and nomination committees) through the presence of independent directors. Latest revision of MCCG 2012 focuses to strengthen the board structure and composition in recognizing the role of directors as active and responsible fiduciaries. The directors are to perform effective stewards and guardians of the company in overseeing the strategic direction and conduct of business as well as to protect the best interests of the company and its shareholders (MCCG, 2012).

The underlined rationale of appointing independent directors as stipulated in MCCG (2012) is mainly for them to exercise independent judgment, provide balance view in giving out opinion and mitigate the conflict of interest or influence of any interested parties. Most importantly, independent directors must assume independent and objective judgment in board deliberations and decision making process of important business decisions (MCCG, 2012). Given limited time spent in the company and constrained in accessing privilege information cause difficulty in performing diligent duties and judgment (Annuar, 2012). Hence, those essential criteria like diversity in skill and experience are crucial for them to play their oversight duties effectively (MCCG, 2012). Latest MCCG (2012) also reinforces annual assessment on the independence of its independent directors. Eventually, main purpose of MCCG is to increase quality of board oversight, bring on independent judgment and lessen the possibility of damaging conflict of interests. Another rationale of appointing independent director is to monitor top management performance and to further improve the shareholder value through higher firm performance.

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