Introduction

Background

This Introduction to Pull-out I (“Board Leadership and Effectiveness”) is designed to provide boards with broad guidance in promoting the application of good corporate governance within the company. The Introduction also intends to provide boards with direction in implementing the Practices and the Step Ups of Principle A in the Malaysian Code on Corporate Governance (“MCCG”) and thus, should be read in conjunction with the write-ups on the individual Practices and Step Ups encapsulated in this Pull-out.

For about 2,000 years, man thought of earth as the centre of the universe. Indeed, this was most famously postulated by Aristotle and became the accepted wisdom until after the end of the Middle Ages, when Galileo’s observation dismantled the “truth” and disproved what was almost universally thought to be correct. Framers and thought leaders of corporate governance alike have always intended the board of directors to be the centre of the company’s “universe”, as it were, but unlike Aristotle’s theory, this model still holds true. It is widely accepted that a company’s corporate governance begins and ends with its board of directors.

The board has the power to shape the company’s direction and culture through its corporate governance philosophy and practices. In addition, as strange as it might sound, the board also influences the company’s corporate governance through its inaction, albeit in a negative way, leaving a vacuum that management and employees have to fill.

An effective board does not place itself in a comfortable setting and it does not remain static. A dynamic board should constantly evolve in response to the environment in which it operates. Challenge as well as teamwork are essential features of the board. Diversity in board composition is an important driver of a board’s effectiveness, creating a breadth of perspective among directors. Whilst the importance of constituting a board optimal for the company’s size and complexity is well understood, less appreciated is the need for the board to perform at the levels expected of it. Indeed, in the oft-cited story of Enron Corporation, its board was composed of eminent individuals who were all highly experienced and qualified. However, the board failed to discharge its duties adequately, ultimately leading to the company’s demise.

It is vital that board members see their directorships as a journey of stewardship rather than a position of privilege. The notion of stewardship points that directors have a responsibility not only to themselves but to the company, its shareholders and other stakeholders as well. Having said that, it is also important to iterate that good corporate governance is not against self-enrichment, as this is a key driver in a free economy. Rather, good corporate governance calls for directors to walk down the path of enrichment in an ethical and sustainable manner.

This Introduction is set out over four sections. Section I addresses board leadership whilst Section II explores board dynamics. Section III sheds light on the nominating committee and lastly, Section IV discusses on the remuneration committee.
Board leadership

Understanding board’s responsibilities

In framing the responsibilities of the board in leading the company, Guidance to Practice 1.1 of MCCG indicates that the board should not treat its responsibilities narrated in the MCCG as definitive and exhaustive. This approach recognises that companies are unique entities with their own circumstances and rigid prescriptions do not work. Considerations on the responsibilities of the board are covered in detail in the write-up to Practice 1.1.

Directors of a company, executive or non-executive, have an obligation to exercise unfettered judgment, in good faith with due care and skill. A director must be aware of the legal parameters that define his or her duties in law. A director owes fiduciary duties similar in some respects of those of a trustee. The diagram on the following page illustrates the core duties of a director.
The primary responsibilities and key duties of the board in this regard are well contained within the **Companies Act 2016** as shown below.

<table>
<thead>
<tr>
<th>Section 211 (1) and (2) of Companies Act 2016 – Functions of Board</th>
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<tr>
<td>(1) The business affairs of a company shall be managed by, or under the direction of the Board.</td>
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<tr>
<td>(2) The Board has all the powers necessary for managing and for directing and supervising the management of the business and affairs of the company subject to any modification, exception or limitation contained in this Act or in the constitution of the company.</td>
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<thead>
<tr>
<th>Section 213 (1), (2) and (3) of Companies Act 2016 – Duties and responsibilities of directors</th>
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<tbody>
<tr>
<td>(1) A director of a company shall at all times exercise his powers in accordance with this Act, for a proper purpose and in good faith in the best interest of the company.</td>
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<tr>
<td>(2) A director of a company shall exercise reasonable care, skill and diligence with –</td>
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<tr>
<td>(a) the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and</td>
</tr>
<tr>
<td>(b) any additional knowledge, skill and experience which the director in fact has.</td>
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<tr>
<td>(3) A director who contravenes this section commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding five years or to a fine not exceeding three million ringgit or both.</td>
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**Note:** The above only represents an extract of the duties and responsibilities of directors.

**Board’s role in setting strategy**

It is commonly observed that for some companies, the board is content to set the strategy at the highest level whilst for other companies, the board’s approach is to be involved in strategy setting, even for each subsidiary.

In terms of strategy, there is a conscious shift by the **MCCG** which now calls upon boards to devote the necessary time and effort to set the company’s strategy, as opposed to endorsing it. It is acknowledged that some boards have a tendency to “outsource” strategy setting entirely to management, leaving the board with little or no input on the company’s long-term direction. It is illuminating to note that in high-performing companies, board members typically “roll their sleeves” and become involved intimately in the formation of corporate strategy. For example, General Electric Company holds its annual strategy session every mid-summer, and during this time board members and senior management break out into small groups, producing building blocks that make up the company’s multi-year strategy\(^1\).

Besides setting the strategic direction of the company, the board must also institute a regular and formal board strategy review. This involves analysing the existing corporate strategy, examining progress towards designated objectives and evaluating current performance in light of these objectives. It should be a high-level review of both the internal and external factors affecting the company, conducted by the board and separate from any management review of strategy.

Board strategy reviews should be undertaken periodically (depending on the requirements of the company) and in the midst of rapidly changing environments and market conditions, at short intervals. Boards need to be vigilant in assessing the company’s performance in achieving its strategy. A report card (prepared by management twice a year) should incorporate exception reporting to assist the board to come to terms with what is not working and why, whilst re-examining the underlying strategic issues.

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\(^1\) General Electric Company, *Proxy Statement*, 8 March 2017
Rather than merely trying to anticipate changes in the marketplace, a board should also ensure that the company’s capabilities and resources are sufficient to manage uncertainties. In this regard, strategic plans should be flexible and this can be achieved by:

- scanning the business environment constantly and keeping abreast of changes that could materially affect the achievement of strategic objectives;
- exploring how business environmental shifts may impact strategy;
- inviting subject matter experts to address the board and senior management;
- ensuring accurate and timely information reaches the board and is deliberated by directors and management; and
- scheduling “break-out” sessions to allow the board to critique the current strategy.

**Ethical leadership by the board**

A company’s ethical culture is largely shaped by the tone at the top (i.e. the company’s leadership). Ethical principles and values need to originate from the leaders and be embedded across the company.

In this regard, the code of conduct and ethics would go a long way in setting out the company’s expectations with regard to business and professional behaviour and topics such as conflict of interest, insider trading, related party transactions, commitment against corrupt practices and of late, anti-money laundering and financing of terrorism.

Considerations on the establishment of a code of conduct and ethics are covered in detail in the write-up to Practice 3.1.

Whilst it is important for companies to develop codes of ethics and business conduct and for internal audit and compliance reviews to routinely uncover areas of concern, it would also be beneficial for companies to create an environment where management and employees can whistleblow on improper behaviour without being victimised for doing so. Improper behaviour is most commonly associated with corruption, but impropriety also extends to matters such as endangering the health and safety of workers, polluting the environment, and denying local communities their rightful dues when purchasing from them. Considerations on the establishment of a whistleblowing policy are covered in detail in the write-up to Practice 3.2.

**The role of chairman and chief executive officer (“CEO”)**

Practice 1.2 of MCCG sets out the role of the chairman and further, Practice 1.3 of MCCG promotes for the role of chairman of the board and the CEO to be held by two different individuals. Separation in this regard is essential as both roles are distinct, have different expectations and serve different primary audiences (as depicted below).

<table>
<thead>
<tr>
<th>The chairman</th>
<th>The CEO</th>
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<tr>
<td>Serves an audience of fellow directors. Runs the board efficiently and in an effective manner. Collectively with the board, the chairman holds the management team accountable towards meeting strategic objectives (covered in detail in the write-up to Practice 1.2).</td>
<td>Serves an audience of management team and employees. Contributes to strategy and runs the company to meet its objectives. The CEO is accountable to the board.</td>
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When each party is free to concentrate on his or her role, one can expect improved outcomes in terms of sharper focus and higher quality of deliberation. Similar to a thriving national democracy that features three distinct branches which share power and act as check and balance, namely the executive, legislative and judiciary, so does an appropriate balance of power between the chairman, CEO and the non-executive directors facilitate an accountable and high-performing board. Considerations on the separation of role between chairman and CEO are covered in detail in the write-up to Practice 1.3.

Role of company secretary in supporting the board and its committees

It is important for the board to be equipped with adequate resources to carry out its oversight duties. In this regard, as outlined in the write-up to Practice 1.4, the company secretary is slowly but surely transforming from being just an administrator and facilitator of board proceedings into an advisor on corporate governance. In fact, in Australia, the Chartered Secretaries Australia has rebranded itself as the Governance Institute of Australia, and in the United States, the Association of Corporate Secretaries changed its name to the Association of Corporate Secretaries and Governance Professionals. The increasing complexity of corporate law and listing rules, better awareness of corporate governance and higher acceptance of sustainability concepts, have all contributed to the importance of the company secretary.

The company secretary plays an important role in advising the board, usually through the chairman, on governance matters and in ensuring that there is an effective system of corporate governance in place. The company secretary also plays a key role in guiding and advising the board on compliance matters such as company law and listing requirements. In order to contribute and function effectively, the company secretary must be qualified, experienced and capable of carrying out duties attached to the post. In addition, the company secretary would need to keep himself or herself abreast with the many developments around corporate and securities law, listing rules and corporate governance practices. Accordingly, a structured training programme should be in place for the company secretary to maintain his or her knowledge and skills.

The board relies on the company secretary to furnish board papers and on this count, not only must the board papers be timely, they should also contain information at an adequate level of detail. Guidance to Practice 1.5 of MCCG calls for board papers to be circulated at least five business days before a board meeting, and whilst directors do not expect excessively voluminous papers, neither do they appreciate a one-page document that overly summarises a key matter. Directors should also be aware that selective disclosure of information in board papers may happen, in which risk factors, worst case scenarios or less flattering information is filtered out. It is important to recognise that selective reporting to the board may lead to skewed decisions and the process of board’s deliberation can only be enhanced through complete and balanced disclosure of information.

In terms of board discussions, it is in the directors’ enlightened interest that the deliberations are recorded in an adequate and timely manner. This includes comments by each director, how the directors voted and whether pertinent objections and reservations have been minuted accordingly. As the saying goes, “what is not minuted, is not said”. Considerations on information and support to directors are covered in detail in the write-up to Practice 1.5.

Professional development and continuous education for directors

It is as such important for every director to keep abreast of his or her responsibilities as a board member vis-à-vis the listed issuer. Every board is unique in terms of its own history, culture and dynamics. Workings of one board may not be entirely applicable on another board. Therefore, induction will be vital for newly appointed directors to orientate themselves in the new environment in order to contribute to the board.

A formalised orientation and education programme should be developed and provided to new members of the board to ensure that they understand:

- their roles and responsibilities;
- the board’s expectations in terms of their knowledge contribution;
the nature of the company’s business;
• current issues faced; and
• strategies adopted by the company.

Induction programmes could comprise a combination of written materials, presentations and activities, such as meetings and site visits. Induction programmes of an interactive nature could also foster constructive relationships between the newly appointed director and existing directors and senior management.

Essential information during the induction of a new member may contain the following:

• Corporate information – company history, product and services information, strategic and business plans, financial accounts, major shareholders, corporate communications, business and industry environment, industry players, risk profile and appetite;
• Corporate governance framework – board charter, code of conduct and ethics, annual work plan, board and directors’ details, committee structure and terms of reference, board processes, assurance providers, resources available, key stakeholders, policies and procedures; and
• Management information – names and background of senior management, organisational and management structure outline.

Directors who are well-informed are in a better position to evaluate proposals made by management, to ask the right questions of management and to be more effective as directors. The board must evaluate the training needs of its directors and ensure that they undertake relevant professional development and upskilling programmes. Effective board, committee and director performance assessments are key in the identification of training, education and development needs. Considerations relating to the assessment of the board, board committees and individual directors are covered in detail in the write-up to Practice 5.1.

Typically, the competencies of board members can be enhanced and refreshed by, amongst others:

• participating in seminars and workshops that highlight techniques to enhance shareholder value and methods to evaluate business performance and capital proposals;
• keeping themselves abreast of regulatory and legislative reforms that impact board and committee work;
• gaining understanding of financial statements and investment products which the company may be exposed to;
• participating in industry conferences and symposiums which strengthen professional networking and allows for the gaining of insights on customers and competitors; and
• visiting company’s operations sites to gain insightful perspectives of matters concerning the staff, factory, department or plantation (as the case may be).

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2 Annual work plan is a document that sets out and prioritises the board’s activities for the year to guide and ensure that the board focuses on important matters. It typically covers, amongst others, the annual review on the company’s business, strategic and risk management plan; annual budget; board succession and assessment review; board induction and training programme; key reporting dates for board committees; meeting with auditors and engagement with stakeholders.
Regulatory requirements concerning directors’ training are outlined below:

**Paragraph 15.08 of Bursa Securities Listing Requirements**

**Directors’ training**

(1) A director of a listed issuer must ensure that he attends such training programmes as may be prescribed by the Exchange from time to time.

(2) The Exchange considers continuous training for directors of listed issuers as important to enable the directors to effectively discharge their duties. In this respect, the board of directors of a listed issuer must on a continuous basis, evaluate and determine the training needs of its directors. The subject matter of training must be one that aids the director in the discharge of his duties as a director.

(3) The board of directors must disclose in the annual report of the listed issuer, a statement on the training attended by its directors which includes the following information:

   (a) the board has undertaken an assessment of the training needs of each director;
   (b) a brief description on the type of training that the directors have attended for the financial year; and
   (c) in exceptional circumstances where any director has not attended any training during the financial year, valid justifications for the non-attendance of such director.

*Note: Paragraph 2.2 of Practice Note 5 of Bursa Securities Listing Requirements [in respect of paragraph 15.08 (1)], also provides, amongst others that a director who is appointed for the first time as a director of a listed issuer must complete the Mandatory Accreditation Programme prescribed by the Exchange within 4 months from the date of appointment.*

**Establishing a board charter**

Similar to a company that has its constitution as a fundamental guiding document, a board has the board charter as its “constitution”. The board charter plays a vital role in helping the board to focus on matters that are pertinent to the company whilst also reminding the board that such matters require consistent attention and are not just one-off items. The board charter sets out the board’s strategic intent, authority and terms of reference and serves as a primary source of reference and induction literature. As the board charter is an avenue to communicate the company’s approach to important governance practices, it should be accessible to all stakeholders via the company’s website. The following are some of the matters that should be considered when developing a board charter:

- a general outline of the board’s purpose, key values and principles;
- an overview of the board’s monitoring role;
- structure and membership of the board (including appointment of directors\(^3\), incorporating aspects of board independence and diversity);
- appointment of board committees;
- a formal schedule of matters reserved for the board including demarcation of responsibilities between board, board committees and management;
- a position description of the role of the chairman, CEO and executive directors as well as non-executive directors;

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\(^3\) The qualification of directors and other key officers is stated in paragraph 2.20A of Bursa Securities Listing Requirements which is described in Footnote 6 of this Introduction.
expected time commitment of directors and limits on directorships (including a restriction of five directorships in listed issuers as stipulated in paragraph 15.06 of Bursa Securities Listing Requirements);

agreed procedure on taking independent professional advice at the company’s expense in furtherance of the directors’ duties (whether as a board or in their individual capacity); and

procedures for the development, undertaking, and improvement of board processes, including the assessment of performance and continuing education and development of the board, its committees and directors.

In a similar fashion, charters for each board committee should clearly set out the duties, rights and expectations for the committee. There needs to be harmony between the board charter and board committee charters, with careful attention paid to the delegation of authority from the board to the board committees. This delegation should not contradict the company’s authority matrix. A board committee charter may be granular and wide-ranging in describing the authority of the committee, but it should also be clear that ultimately, responsibility for decisions or recommendations taken by the board committee rests with the board as a whole.

Considerations on the establishment of a board charter are covered in detail in the write-up to Practice 2.1.

Section II Board dynamics

The success of the board in fulfilling its oversight responsibility depends on its size, composition, and leadership qualities. A vigilant board, whilst supportive of management, must proactively participate in strategic decisions, challenge management with questions based on informed knowledge, oversee management’s plans, decisions and actions, monitor management’s ethical conduct, financial reporting and regulatory compliance and be capable of effectively achieving good governance and protecting stakeholders’ interests.

The diagram below provides guidance on the five key steps in establishing an effective board:
Size and composition of the board

The composition of a board remains a key ingredient in influencing how the board functions and the dynamics between its members. The term “composition” has a number of dimensions – independence, skills, knowledge and other aspects of diversity. Whilst MCCG has steered clear of prescribing a fixed formula for the board’s composition, it does emphasise that the board should be composed of a strong element of independence (i.e. the board should comprise a group of independent directors who act as such in name and in substance). Whilst this is good practice for all companies, it is particularly pertinent for listed issuers where some stakeholders (i.e. non-controlling shareholders) have a direct financial interest in the company, as opposed to a private company in which the shareholders and management are often the same people.

Generally, the board comprises three distinct parties, namely, the chairman, the executive directors (usually led by the chief executive or managing director) and the non-executive directors (including the independent directors). Practice 4.1 of MCCG has called upon companies to have at least half of the board composed of independent directors in order to foster greater objectivity in the boardroom.

Considerations on the composition of the board having at least half or for Large Companies, a majority of independent directors are covered in detail in the write-up to Practice 4.1.

Independent directors

Independent directors can make significant contributions to a company’s decision-making by bringing in the quality of detached impartiality.

An independent director is especially important in areas where the interests of management, the company, the shareholders and other stakeholders diverge, such as executive performance and remuneration, related party transactions, environmental issues and audit. In this regard, an independent director ought to be able to approach any issues discussed or matters presented for approval at the board level, with a watchful eye and an inquiring mind.

An important facet of independent directors that is garnering increasing attention is their tenure of service. The argument in introducing limits to tenure of independent directors is that familiarity increases and objectivity decreases over time. Premised on the need to promote greater independence and objectivity, Practice 4.2 of MCCG calls for the board to limit the tenure of independent directors to nine years. The said Practice further calls upon an independent director who continues to serve on the board after such a period, to cease to be an independent director, and become a non-independent non-executive director. For companies that choose to retain the services of their independent directors after nine years, shareholders’ approval should be sought on an annual basis and after the twelfth year, shareholders’ approval is sought through a “two-tier” voting process as below.

- the first tier comprises approval of the Large Shareholder(s) of the company; and
- the second tier comprises approval of the shareholders other than Large Shareholder(s).

Step Up 4.3 of MCCG calls upon boards to have a policy to limit the tenure of their independent directors to nine years. Considerations relating to the tenure limit for independent directors are covered in detail in the write-up to Practice 4.2 and Step Up 4.3.

4 Large Companies are companies on the FTSE Bursa Malaysia Top 100 Index; or companies with market capitalisation of RM2 billion and above, at the start of the companies’ financial year.
5 As stated in Guidance to Practice 4.2 of MCCG. Large Shareholder means a person who is entitled to exercise, or control the exercise of, not less than 33% of the voting shares in the company; is the largest shareholder of voting shares in the company; has the power to appoint or cause to be appointed a majority of the directors of the company; or has the power to make or cause to be made, decisions in respect of the business or administration of the company, and to give effect to such decisions or cause them to be given effect to.
Establishing a nominating committee is essential to ensure that there is a structured oversight process in recruiting, retaining, training and developing the best available executive and non-executive directors, and that board renewal and succession are managed effectively. Understanding the role played by the nominating committee is integral to understanding how interactions among the directors with varied backgrounds can have an impact on decision-making and outcomes. This will enable the nominating committee to build the right board structure and develop an effective functioning group, rather than a group of independently operating individuals or a group of collegial friends.

**Paragraph 15.08A of Bursa Securities Listing Requirements** mandates the establishment of the nominating committee which must comprise exclusively of non-executive directors, a majority of whom must be independent.

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**Paragraph 15.08A of Bursa Securities Listing Requirements**

**Nominating committee**

(1) A listed issuer must establish a nominating committee which comprises exclusively of non-executive directors, a majority of whom must be independent.

(2) The nominating committee must have written terms of reference dealing with its authority and duties which must include the selection and assessment of directors, and such information must be made available on the listed issuer’s website.

(3) The listed issuer must provide, in its annual report, a statement about the activities of the nominating committee in the discharge of its duties for the financial year. Such statement must include how the requirements set out in paragraph 2.20A of these Requirements are met and contain the following information:

- the policy on board composition having regard to the mix of skills, independence and diversity (including gender diversity) required to meet the needs of the listed issuer;
- the board nomination and election process of directors and criteria used by the nominating committee in the selection process; and
- the assessment undertaken by the nominating committee in respect of its board, committees and individual directors together with the criteria used for such assessment.

The nominating committee should establish clear and appropriate criteria on the selection and recruitment as well as on the annual assessment of the board, board committees and individual directors. Such criteria should be developed, taking into consideration the suitability of candidates against considerations such as competencies, commitment, contribution and performance, including the current composition of board and board committees, mix of skills and experiences of directors whilst taking into account the current and future needs of the company, boardroom diversity (including gender diversity) and other soft attributes required as company directors.

A far-sighted and effective nominating committee will normally keep an eye on the need for succession in the boardroom, identify appropriate candidates for board’s approval to fill casual vacancies and nominate candidates for the board’s consideration. Such activities should be carried out without being

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6 Paragraph 2.20A of Bursa Securities Listing Requirements stipulates that every listed corporation, management company or trustee-manager must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role as a director, chief executive or chief financial officer, as the case may be, of the listed corporation, or the collective investment scheme.

7 Bursa Malaysia Securities Berhad has vide its directive dated 22 July 2014 clarified that a listed issuer is required to disclose in its annual report issued on or after 2 January 2015, its diversity policy for its board of directors in terms of gender, age and ethnicity as part of the enhanced disclosure requirements to paragraph 15.08A of Bursa Securities Listing Requirements.
beholden to executive directors or controlling shareholders. The nominating committee and the board should devote sufficient time to review, deliberate and finalise the nomination and/or selection of directors. In a 2014 study conducted by PwC covering over 2,300 family businesses of varying revenue, only 16% have a documented succession plan. Closer to home, the PwC study stated that only 16% of the 50 Malaysian family business have such a plan. Succession planning has gained added significance given contemporary thinking that independent directors should not stay beyond a certain period of time. If the board wants to increase the survivability of its company, it would do well to maintain succession planning on its radar.

On a related note, it is not often understood or appreciated that the succession planning process is closely linked to the performance evaluation of directors. To put it in another way, the assessment outcome has a bearing on the coming and going of directors. In essence, the assessment process for the board, board committees and individual directors, when done correctly, can impact the board in a few ways:

- gaps in skills, competency or experience are identified and plugged through recruitment of suitably qualified directors;
- under-performing directors receive notice that improvement is expected lest they find themselves being eased out of the board; and
- better ways of doing things are explored and considered.

In addition to leading the vetting of candidates and the necessary conversations around succession planning, particularly for the chairman of the board and the CEO, the chairman of the nominating committee also has the responsibility of assessing the performance of board, board committees and individual directors, be it newly appointed directors or existing ones. Considerations on nominating committee being chaired by an independent director or senior independent director is covered in detail in the write-up to Practice 4.7.

Boards can benefit from engaging an external and independent party to facilitate the assessment process. The said party is expected to deliver a neutral view of the board’s strengths and areas for improvement, and can also add insights gained from other evaluations. This is a benefit that is not often taken into account when considering the use of an external party. In respect of Large Companies, Guidance to Practice 5.1 of MCCG calls upon these companies to disclose the assessment process, whether external facilitators were involved, what were the major findings and how does the board intend to address weaknesses identified. Considerations on the board evaluation process are covered in detail in the write-up to Practice 5.1.

Board diversity

Diversity and inclusiveness are becoming increasingly important in tandem with the globalisation agenda whereby world barriers are being broken down as people connect more and more through trade, travel and migration. Indeed, two notable studies have concluded that companies which embrace diversity have performed better than their peers.

Boards through their nominating committee should take appropriate measures to ensure that boardroom diversity is sought as part of their selection and recruitment exercise. In pursuing its diversity agenda, the board should begin by assessing its current diversity levels and establishing a policy that demonstrates clear commitment to developing a corporate culture which embraces the different aspects of diversity. The board should also formulate targets and measures (for example, where relevant, by way of key performance indicators or initiatives/development programmes/career

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9 In a regional study conducted by Korn Ferry in 2016 across the largest 100 companies in 10 Asia-Pacific countries (including Malaysia), it was found that companies with at least 10% female board representation recorded higher returns on assets and equity than companies which lack thereof. A global study by McKinsey in 2015 across 366 public companies in Canada, Latin America, United Kingdom, and United States revealed that companies in the top quartile for gender or racial and ethnic diversity are more likely to reap the benefits of diversity by having financial returns above their national industry medians.
advancement plans) of the board, the CEO and other senior management personnel. These targets and measures should be annually assessed and the progress should be monitored.

Nominating committees should put in place policies that actively support women to be directors by assisting women in senior management to build business networks, encouraging them to join boards as part of their professional development and addressing cultural impediments which prevent women from reaching senior management and board positions. The nominating committee should have measurable targets for achieving gender diversity. Nominating committees are strongly encouraged to annually assess their policies and outcomes to determine if they are effective. Where targets are not achieved, they should disclose their plans for improvement.

Gender diversity policies will only bring about desired outcomes if there is commitment and promotion of a corporate culture that embraces diversity. The MCCG recognises that benefits can accrue through all levels of the company, and has accordingly also asked that diversity be reflected in the senior management team. In particular, women are now recognised as an equal contributor to the prosperity of companies and the wider economy. Volvo, for example, has long involved women in the design and development of its cars, including an all-female focus group, engineering teams and designers. Considerations on board diversity are covered in detail in the write-up to Practices 4.4 and 4.5.

In relation to sourcing of directors, Practice 4.6 of MCCG calls upon independent sources to identify suitably qualified candidates. As stated in Guidance to Practice 4.6 of MCCG, companies should disclose how newly appointed non-executive directors are identified – were they recommended by board members, or were other means used to locate and recruit them. If non-executive directors were recommended by current board members, the onus is on the company to explain why alternative channels were not considered. Considerations in relation to sourcing of directors are covered in detail in the write-up to Practice 4.6.

Remuneration committee

Establishing a committee to assist the board in developing and administrating a fair and transparent procedure for setting policy on remuneration of directors and senior management is important because this would ensure that remuneration packages are determined on the basis of the directors’ and senior management’s merit, qualification and competence, having regard to the company’s operating results, individual performance and comparable market statistics. The remuneration committee’s remit should cover not only directors’ remuneration but also that of the senior management team. In some companies, the committee addresses remuneration for the whole company. In all cases, both salient features of the company’s remuneration structure and the work of the committee in arriving at the structure should be disclosed by the company.

As stated in Guidance to Practice 6.2 of MCCG, the remuneration committee should only consist of non-executive directors and a majority of them must be independent directors, drawing advice from experts, if necessary. Directors who are shareholders should abstain from voting at general meetings to approve their fees. Similarly, executive directors should not be involved in deciding their own remuneration.

It is clearly important for the remuneration of directors and senior management to be determined adequately and fairly. Whilst not new concepts, the terms “adequately” and “fairly” have been gaining increasing attention in recent years in relation to directors’ remuneration. Firstly, it is no longer acceptable for directors and senior management to be remunerated without a reasonable basis for arriving at the quantum. There needs to be an appreciable link between the directors and senior management’s remuneration packages and how the company is performing, and also appropriate reasoning behind how remuneration is structured (i.e. whether short term or long term).

10 Madslien, J 2004, Girl Power softens Volvo’s edges, BBC
Secondly, consideration needs to be given to the ratio between the directors and senior management’s average remuneration versus that of the wider employee group. In this regard, the following questions may be asked:

- Is the ratio excessive or within reasonable levels? Would the company be able to justify a substantial increase in directors’ or senior management’s remuneration when the average pay of the broader group of employees remains the same?
- What would the perception of stakeholders be on the remuneration awarded to directors and senior management? Requirements on transparency of remuneration structure, activism of stakeholders and the media have combined to force the topic of remuneration onto the public space.

Considerations on remuneration policies and procedures of directors and senior management as well as the establishment of remuneration committee are covered in detail in the write-up to Practices 6.1 and 6.2 respectively.

In line with contemporary thinking, the MCCG also emphasises that disclosure not only refers to features of the company’s remuneration structure, but also extends to identifying directors and senior management along with their remuneration. The MCCG intends for stakeholders to be able to assess whether the remuneration of directors and senior management is commensurate with their performance and the company’s performance.

Directors should bear in mind that the intent of disclosure is not for frivolous reasons but for investors and other key stakeholders to assess the reasonableness of remuneration, in light of the company’s circumstances, performance and prospects. This disclosure forms a key input in a shareholder’s evaluation of the directors and how they have discharged their stewardship duties. In particular, companies who put their remuneration structure to vote can expect shareholders to support if the bases behind the structure are clear, reasonable and defensible.

Considerations on the disclosure of directors and senior management’s remuneration are covered in detail in the write-up to Practices 7.1 and 7.2 as well as Step Up 7.3.