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**POLITICAL INFLUENCE, CORPORATE GOVERNANCE AND
FINANCIAL REPORTING QUALITY: EVIDENCE FROM
COMPANIES IN MALAYSIA**

A thesis presented in partial fulfilment of the requirements for the degree of

Doctor of Philosophy
in
Accountancy

at Massey University, Wellington,
New Zealand

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2009

ABSTRACT

This study investigates the relationship between political influence, corporate governance and financial reporting quality using Malaysian data spanning 1999–2003. The study builds upon agency theory, analysing the conflicting incentives of politicians, shareholders and managers, and how they affect governance and financial reporting. Four hypotheses are put forward: (1) Political influence is associated with lower financial reporting quality; (2) Political influence is associated with weaker corporate governance; (3) After controlling for political influence, weak corporate governance is associated with low financial reporting quality; and (4) Corporate governance mediates the relationship between political influence and financial reporting quality. In addition, knowledge obtained from interviews of top managers from several companies is used to look further at the influence of politics in managerial decision-making, particularly in relation to governance structure, accounting and reporting.

Malaysia offers an interesting and important case study of relationship-based capitalism. Malaysian companies are regarded as politically sensitive, they are highly concentrated, and government participation in equity ownership is significant.

One advance is that this study uses three observable proxies for political influence: government ownership, the presence of politician/s on the board, and the existence of a golden share giving special rights to the government. It appears that political influence is not a single construct. The findings support previous studies only if political influence is defined as the presence of politician/s on the board. Government ownership improves both governance and reporting quality, contrary to the findings of most previous studies. Having a golden share is not associated with governance or financial reporting quality. These findings suggest that institutional details matter when considering the effect of political influence on corporate governance and financial reporting. Findings from interviews provide a rich source of support for some of the quantitative findings, and new details on the complexity of the relationship between governments, boards and managers.

Overall, the study provides insights and additional guidance for regulators and policy makers, for improving the design of corporate governance features and financial reporting frameworks as well as for deciding on the level of involvement of government and politicians in business. The contrasts with findings of earlier studies in Western economies suggest opportunities for future research to understand the sources of the differences.

ACKNOWLEDGEMENTS

I am greatly indebted to my supervisors Professor Paul V Dunmore and Dr Nives Botica Redmayne for their support and encouragement throughout my PhD journey. They have provided invaluable critical evaluation and guidance throughout all stages of the study and this thesis. My grateful thanks to you both.

I gratefully acknowledge the contribution of Associated Professor Agus Yusof from the Political Science Department Universiti Kebangsaan Malaysia, who helped to verify the presence of politicians on board of directors; Edmond Lim as a second scorer of corporate governance and disclosure quality; Encik Farid Omar and Dato' Haji Mat Ali, who made it easier for me to access most of the top management personnel through their personal connections and networks. Thank you to all the participants of the interviews. This study could not have been completed without your interest and participation.

I would like to thank the Universiti Kebangsaan Malaysia and the Ministry of Higher Education of Malaysia for the granting of a scholarship which enabled me to undertake study leave and pursue my doctoral studies.

Special thanks to members of the School of Accountancy, Massey University for their friendship and moral support, and to Hana Craig for patiently reading and editing the manuscript.

Finally and most importantly, my deepest appreciation goes to my parents, Hajjah Zaharah Man and Haji Md Salleh Bin Abd Wahab. This thesis is dedicated to both of you for sacrifices made to teach me what life is all about. This thesis is also dedicated to my grandmother, Ishah and my late grandfather, Abdul Rahman. Both of you have been a source of great encouragement and inspiration throughout my life. Thank you so much for having always believed in me and the unconditional love that I have received.

Fairuz Salleh
Wellington, 2009

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LIST OF ABBREVIATIONS

ADR	American Depository Receipt
AIMR	Association for Investment Management and Research
CAPM	Capital Asset Pricing Model
CC	Commercial Code
CCM	Companies Commission of Malaysia
CFRA	Center for Financial Research and Analysis
CIFAR	Center for International Financial Analysis and Research
CLSA	Credit Lyonnais Securities Asia
CPA	Certified Public Accountant
EOI	Export Oriented Industrialisation
FAF	The Financial Analysts Federation
FASB	Financial Accounting Standards Board
FRA	Financial Reporting Act
FRQ	Financial Reporting Quality
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standard Committee
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
ISI	Import Substitution Industrialisation
ISS	International Shareholder Services
ITC	International Trade Commission
KLSE	Kuala Lumpur Stock Exchange
MASB	Malaysian Accounting Standards Board
MCA	Malaysian Chinese Association
MCCG	Malaysian Code of Corporate Governance
MIA	Malaysian Institute of Accountants
MICG	Malaysian Institute of Corporate Governance

MICPA	Malaysian Institute of Certified Public Accountants
MIM	Malaysian Institute of Management
MYR	Malaysian Ringgit
NACRA	National Annual Corporate Reporting Award
NDP	National Development Policy
NEP	New Economic Policy
NZD	New Zealand Dollar
NZSE	New Zealand Stock Exchange
OECD	Organization of Economic Cooperation and Development
ROB	Registrar of Business
SC	Security Commission
SCA 1993	Security Commission Act 1993
SEC	Security and Exchange Commission
SEDC	State Economic Corporation Development
SEL	Securities and Exchange Law
SFAC	Statement of Financial Reporting Concepts
SICDA	Securities Industry Central Depository Act
SOE	State-owned Enterprises
SOCPA	Saudi Organization of Certified Public Accountants
SPSS	Statistical Package for the Social Sciences