

## **CORPORATE GOVERNANCE IN AIR ASIA BERHAD**

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### **ABSTRACT**

The aim of this paper is to discuss the corporate governance practice in Air Asia Berhad. Corporate governance is an important topic discussed in Malaysia as the government is fully supporting corporate governance issue by introducing the Malaysia Code of Corporate Governance (MCCG) for organizations in Malaysia to follow. Although there are issues on corporate governance failure appearing in the papers quite frequently, but there are also organizations that have a good corporate governance in place. This paper will discuss the corporate governance practice in one of Malaysia's successful carrier. This paper first examines the level of corporate governance and its impact on firm performance which further branched out to board composition, financial disclosure and whistleblowing channel. Inside Air Asia Berhad, the author found that the organization fully complies with the recommendation of board composition plus they have a broad spectrum of board of directors with experience, expertise and reputation for integrity. Secondly, financial disclosure of Air Asia Berhad is fully transparent where all of the information is available in their website for investors to view and acquire. In addition, they have their own external auditors to ensure there is no manipulation of financial reports of the organizations. Thirdly, Air Asia Berhad have an internal whistle blowing channel which is delivered through email, contrasting with Dqorkin and Callahan (1993), stated that the best choice is external whistleblowing channel rather than internal as internal would create extensive form of retaliation to the employee from management. On the basis of the results of this research, it can be concluded that Air Asia Berhad, an organization in the airline industry takes corporate governance practice to its core and complying with the government effort on raising the corporate governance inside of Malaysia.

**Keywords:** Corporate governance, Board composition, Whistle-blowing, Financial disclosure

## INTRODUCTION

To sustain a good business, a set of good system to control and direct the company towards their goal is very important. This term is known as corporate governance. In year 1992, Cadbury Report was established by a committee led by Sir Adrian Cadbury on the financial aspects of corporate governance. This is the trigger point where the traditional mind set is to sustain business by having a huge amount of money was neglected and people start focusing on corporate governance as the crucial part in order to sustain business. Corporate governance issue became more interesting to be discussed with the Enron debacle due to failure of corporate governance practice in year 2001.

During this period, many scholars emphasise on having a good corporate governance which would enable an organization to be sustainable. Numerous elements of good corporate governance were discussed. In Malaysia, when financial crisis occurred in 1997, the necessities for good corporate governance in private sector become more crucial.

In year 2000, Malaysian Code of Corporate Governance (MCCG) was established as guidance to the principles of good corporate governance to be practiced. In this first approach, it focused 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 this 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.

This paper will analyse Air Asia Berhad as public listed company in the private sector on how this company apply good corporate governance base on MCCG 2012 guideline. This study also tries to relate the previous study findings with current Air Asia Berhad corporate governance practice to see it efficiency. Specifically, we will look into 3 main criteria which are the composition of board, quality of financial disclosure and whistle blowing channel.

## LITERATURE REVIEW

### **Level of Corporate Governance and its Impact on Firm Performance**

Impacts of corporate governance level towards firm performance have been study significantly by previous intellectual. During the 1990s, Gompers, Ishii and Metrick (GIM,2003) did a study on the impact of corporate governance on firm performance. They find that that stock returns of firm with strong shareholder right, outperform on a risk-adjusted basis, returns of firms with weak shareholder rights. Contrarily with GIM's study, Core, Guay and Rusticus (2005) claim that in the 2000s, share returns of companies with strong shareholder rights do not outperform those with weak shareholder rights. Subsequently, from time to time, many researchers come with many idea, some are identical some are totally different regarding the impact of corporate governance level on firm performance.

Contradiction of understandings in measuring corporate governance toward firm performance was concluded by Bala, Bernard and Vikram (2010). They found that the benefits of particular corporate governance practices vary depending on firm and country characteristics. In their study they do analyze on various criteria of the firm located in India and do contemporaneous comparison with firm in Brazil. Some of the criteria they analyze are board's composition, financial disclosure and shareholder rights. These are the famous corporate governance feature that always been highlighted in many research.

### **Board Composition**

To gain better corporate governance, board composition always highlighted as the root criteria. Its normally concerns issues related to size of board, independence level of the boards, and CEO duality.

From previous study, it has been recognized that size of board correlated with firm size (Dalton et. Al, 1999; Yermarck, 1996). These findings were explained by theoretical perspective. Agency theories support that larger companies requires greater number of director for monitoring the company's performance. From dependence resource theory, greater number of director will increase access for resources. But there also some argument that said many directors may cause higher argument while reviewing management action. Related to the argument, there is study that concludes that number of directors should have upper limit (Jessen, 1993).

In general, directors can be classified into three categories which are executive director, non-independence non-executive director and independence non-executive director. Executive director or management directors are salaried employees, such as the president, Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Operation Officer (COO). Non-independence non-executive director or related outside directors are those who have a pre-existing relationship with the firm, such as family relatives and retire executives. Independence non-executive director is director who has no personal connections or business dealing with the firm.

In this stage, Agency theory proposes that a more independence non-executive directors inside board will be able to monitor any self-interested actions by managers and so will minimize the agency costs (Fama, 1980; Fama and Jensen, 1983). Contradict with this suggestion, stewardship theory prefer more executive directors as they work to maximize profit for shareholders (Donaldson, 1990; Donaldson and Davis, 1991). Within these two suggestions, Malaysian Code of Corporate Governance 2012 prefers first suggestion as described in principles 3, "Reinforce Independent" (MCCG 2012). On the other hand, Main Market Listing Requirement by Bursa Malaysia Securities Berhad did not reinforce majority independence director because it only required at least two directors or one third of board of director, whichever is the higher must be independent director (Chapter 15, MMLR).

Duality issues of CEO and Chairman were also discussed in this research because good corporate governance always emphasize on the importance of the tone at the top which will lead to better firm performance. From the agency theory's perspective, CEO and chairman position must be held by different individual as this will increase the effectiveness of board monitoring (Finkelstein and D'Aveni, 1994). This theory was argued by stewardship theory

that one person in both roles may improve firm effectivity because it can remove overall ambiguity regarding responsibility for firm processes and outcomes (Donaldson, 1990; Finkelstein and D'Aveni, 1994).

## **Whistleblowing**

Whistleblowing is the act of an individual on exposing any kind of information or activity that is illegal within an organization either it is private or public organization to draw public attention towards the organization involved whereby the issue can be corruption and fraud.

Two ways for the whistleblower to expose the issue, either internally or externally. Internally means the whistleblower will expose the issue to the people in the suspected organization and externally is the whistleblower will expose the issue to the proper external channel such as media, law, authorities or those who are concerned. There are external and internal channel of whistleblowing that an employee can take to whistle any improper activities they notice in the management.

The transparency of the channel varies accordingly for example if the employee blow the whistle, internally, he could face the fact that evidence will be destroyed, employee will be transferred out from the division and employee will have less access to the proof. Besides that, management have the tendency to respond differently to the whistleblower according to the channel the employee took to report as internal route would cause the management to take immediate action to fire the employee and if by external route it would create some dilemma for the management to fire the employee as the problem is highlighted to the public and would create negative perception to the company if the whistleblower if fired (Dqorking and Callahan, 1993).

## **Financial Disclosure**

Financial disclosure is an important information required by investors for decision making. Financial disclosure has a huge impact on risk taking inside an organization as financial statements may not be represented fairly thus deliberately misleading investors about company's operations. Therefore, without a complete information it is impossible to fully understand a company's financial operation. Therefore, a natural next step is the development of a more comprehensive framework for conceptualizing and measuring the key aspects of the domestic information environment. A fundamental feature of the information environment is corporate transparency in financial disclosure.

A conceptual framework for characterizing and measuring corporate transparency in financial disclosure at the country level introduced in Bushman, Piotroski, and Smith (2001). Hereafter they develop a framework for conceptualizing and measuring corporate transparency in financial disclosure at the country level. In their framework, corporate transparency in financial disclosure has two main elements: 1) corporate reporting (voluntary and mandatory) and 2) information dissemination via the media and Internet channels. This paper uses the framework as shown in Table 1 to stimulate further thought on the measurement of corporate transparency in financial disclosure and of domestic information environments more generally.

Table 1: Variable used to measure corporate transparency in financial disclosure and data sources

Variables used to measure corporate transparency in financial disclosure and data sources
Corporate Reporting
Financial Accounting Disclosures
Long-term investments: Research and development, capital expenditures
Segment disclosures: Product segments, geographic segments
Subsidiary Disclosures
Footnote Disclosures
Governance Disclosures
Identity of major shareholders
Range of shareholdings
Identity of managers
Identity of board members and affiliations
Remuneration of officers and employees
Shares owned by directors and employees
Timeliness of disclosures
Frequency of reporting
Number of specific accounting items disclosed in interim reports
Consolidation in interim reporting
Reporting of subsequent events
Accounting policies
Consolidation of subsidiaries
Use of general reserves
Other
Financial statements available in English
Degree of disclosure of important accounting policies
Information dissemination
Penetration of media
Newspapers released
Televisions released
Media ownership

Source: Bushman, R., J. Piotroski, and A. Smith. 2001. "What Determines Corporate

This extended representation of corporate transparency in financial disclosure allows a variety of research questions to be addressed.

## METHODOLOGY

Air Asia Annual Report in year 2015 and Air Asia Webpage in year 2016 was analysed to determine whether the board of directors, whistle blowing and financial disclosure e follows the elements as stated in the literature review section. For the component of board of directors there are three elements that have been examined and they are (i) size of board, (ii) independence of directors and (iii) Chief Executive Officer (CEO) and Chairman which is

clarified from the literature review above. For whistle blowing channels of whistle blowing, whether internal or external were determined. For financial disclosure the conceptual framework for characterizing and measuring corporate transparency by Bushman, Patrioski and Smith (2001) was used.

## ANALYSIS

### Board Composition of Air Asia

#### *Size of board*

The Board believes that it should generally have no fewer than three and no more than 15 members. The size of the Board could, however, be increased or decreased if determined to be appropriate by the Board. Against the board composition of Air-Asia, there are 7 members in board composition.

#### *Independence of directors*

The Board will determine annually, based on all of the relevant facts and circumstances, whether each director satisfies the criteria for independence and must disclose each of these determinations in its filings. The Board may adopt and disclose categorical standards to assist it in making such determinations and may make a general disclosure if a director meets these standards. Any determination of independence for a director who does not meet these standards, however, must be specifically explained.

#### *CEO and chairman duality*

Air Asia Board of charter strictly outlines that Chief Executive Officer (CEO) and chairman must be held by a different individual. This practice supports the agency theories perspective to have different individual for CEO and chairman in order to ensure there are no special interest in decision and increase the effectiveness of monitoring. Inside Air Asia Board, the charter also clearly explains the roles and responsibility of chairman and CEO. Chairman was required to do more overall monitoring of board members performance and decision making job. Chairman also has the important roles to ensure high quality of information and knowledge gain for board. Role and responsibility for CEO, specifically for financial, stakeholder management, operation, customers and people related issues. Clear outline inside Air Asia board of charter can avoid weaknesses of duality issue and improve the governance efficiency.

#### *Whistleblowing*

It is understanding that there are two type of channel for whistleblower to raise the issues which are external and internal. According to the study conducted to Air Asia, we able to recognize that Air Asia prefer channel to whistleblowing to be internal. According to Dqorking and Callahan, (1993) the best choice is external rather than internal as internal whistleblowing would create extensive form of retaliation to the employee from the management. Therefore, to protect the employee from extensive retaliation, Air Asia came

with a policy that would make sure those issue raised by the workers which included the directors, employees and others would be concern genuinely and retaliation is strictly prohibited by the corporate policy and would not be tolerated. Besides that, Air Asia create a platform for the workers to raise the issue which through their email and educate the workers on what matter to be raised and not to rise under the platform. Below shows the issue that could be report and not to report by whistleblower in Air Asia which can be found at the Air Asia Webpage.

Table 2: What to whistleblow and what should not?

Issue should be reported	Issue not to report
Commission of fraud and/or corruption	False and malicious concerns
Unauthorized use of Company's money, properties and/or facilities	Defaming concerns
Non-compliance with Company's policies and procedures and/or code of conduct	Concerns without any basis or insufficient evidence
Negligence/Malpractice	
Disclosure of Company's information without proper authorisation	
Commission of acts which intimidate, harass and/or victimise any members of the Board of Directors, Management or staff of the Company	
Abuse of position	
Involvement in conflict of interest and/or business opportunities positions	
Commission of unlawful acts	
Exposure of Company's properties, facilities and/or staff to the risks of safety and security	
Failure to meet professional standards	
Concealment of any of the above	

*<http://www.airasia.com/my/en/about-us/ir-whistleblowing-channel.page> (2016)*

Therefore, whistleblowing channel in Air Asia actually looks transparent and protective as how Lilanthi.R (2003) claims that to have a transparent and to protect the employee in whistleblowing, first there should be a law to protect the whistle blower and corporations should conduct training to the workers. Beside that Air Asia took the whistleblower channel seriously by appoint legal director to get those reports and direct it to the chairman of the board, audit committee (BAC) and report to management the outcome of the enquiry for further action.

### *Financial disclosure*

Air Asia level of financial disclosure is measured by using a conceptual framework for characterizing and measuring corporate transparency which is introduced by Bushman, Patriotski and Smith (2001). In their framework has two main elements which are corporate reporting and information dissemination via the media and Internet channels, whereby the

results and further description for each element for Air Asia level of corporate transparency is translated into the Table 3.

The elements are considered “fulfilled” when the data from Air Asia Annual Report 2015 disclose the elements proposed by Bushman, Patrioski and Smith (2001). Corporate Reporting reference can be found in annual report that clearly explained about Air Asia corporate structure while Information Dissemination via Media and Internet Channels can also be found in annual report with regards to achievement and events that Air Asia had implemented throughout the year.

Table 3: Variable to measure corporate transparency and data sources

No.	Element 1: Corporate Reporting	
	Variables to Measure Corporate Transparency and Data Sources	Fulfillment of Elements
1	Long Term Investments : Research and Development, Capital Expenditure	Fulfilled
2	Segment Disclosures : Product Segments, Geographic Segments	Fulfilled
3	Subsidiary Disclosure	Fulfilled
4	Footnote Disclosure	Fulfilled
5	Governance Disclosure	Fulfilled
6	Other : Financial Statements Available in English, Degree of Disclosure of Important Accounting Policies	Fulfilled

*(Air Asia Annual Report, 2015)*

The first section of variables used to measure corporate transparency and data sources emphasize on the quality of Air Asia corporate reporting. By using Bushman, Patrioski and Smith (2001) framework and comparing it with the data gathered from Air Asia Annual Report 2015, all of the elements stated in Bushman, Patrioski and Smith (2001) framework was fulfilled. Information was disclosed to the stakeholders.

Table 4: Variable to measure information dissemination

No.	Element 2: Information Dissemination via Media and Internet Channels	
	Variables to Information Dissemination	Fulfillment of Variables
1	Penetration of Media : Press Clippings, Television, Social Media	Fulfilled
2	Air Asia Media Ownership Data	Fulfilled

*(Air Asia Annual Report, 2015)*

Table 4 shows the quality of information disclosed by Air Asia. It shows all elements are fulfilled. In the case of “penetration of media” from the annual report it can be seen that several platforms were used by Air Asia such as social media platform; Line, Twitter, Weibo, Wechat, Instagram, LinkedIn, Youtube, Google+, Pinterest and Viber Public and also networking platforms such as television and newspapers.



## CONCLUSION

This paper identified that Air Asia have their proper corporate governance structure. From the research that had been done, we can conclude that corporate governance in Air Asia is influenced by three elements which are Board Composition, Whistleblowing and also Financial Disclosure. From the view of Board Composition, it is clear that Air Asia follows the guideline of proper corporate governance structure which is size of board, independence of board and also board membership criteria. All of the factors mentioned are properly determined by their audit committee. Next on Whistleblowing, Air Asia have their own internal channel for voicing out whistleblowing which most of the studies had been made suggested using external channel but Air Asia had made a policy which the issue raised by the workers will be treated genuinely and retaliation is strictly prohibited by the corporate policy and would not be tolerated.

In addition, Air Asia had created a platform for workers to raise the issue through their email. Last but not least is the Financial Disclosure, whereby Air Asia is thoroughly transparent with their financial report and it is being made available through their website. Plus, by referring to Bushman, Piotroski and Smith (2001) conceptual framework for characterizing and measuring financial transparency, Air Asia had fulfilled the requirement with flying colors which can be said Air Asia is transparent about their financial disclosure and they do not intent to hide anything from their investors. Considering all of the elements, Air Asia had followed the guidelines for corporate governance for an organization even though they have a different view on whistleblowing channels but the most important are the board composition and financial disclosure as investors really view these elements heavily before considering on investing into an organization.

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