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Assessing the Adoption of Principle a of the MCCG 2021 among SMEs Listed on the Leap Market of Bursa Malaysia: A Focus on Board Composition

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Abstract

This study investigates the implementation level of the corporate governance framework, especially Principle A of the MCCG 2021, among small and medium-sized enterprises (SMEs) listed on the LEAP Market of Bursa Malaysia. Principle A places significant emphasis on board leadership and effectiveness, encompassing the board of directors' composition, operations, and accountabilities. A sample of 43 SMEs listed on the LEAP Market was chosen for the study. Data were collected from Bursa Malaysia and the companies' official websites, primarily focusing on key aspects of board composition, as recommended under Principle A, such as board size, the presence of external and independent directors, female board members, and CEO duality. Descriptive analysis was used to interpret the data. The results indicate that SMEs on the LEAP Market give prominence to a smaller board size and the appointment of independent directors as pivotal governance practices to fortify their governance structure. Nevertheless, the findings also point to inadequate adherence to corporate governance guidelines, particularly in terms of board composition. Despite the study's descriptive nature, it provides valuable insights into the realm of corporate governance, specifically concerning SMEs in Malaysia. Notably, even though there are less rigorous regulatory standards for SMEs on the LEAP Market, establishing an appropriate board composition aligned with Principle A has emerged as a principal focus to enhance corporate governance practices.

Keywords: Board Composition, Corporate Governance, LEAP Market, MCCG, SMEs

Introduction

Small and medium enterprises (SMEs) are defined differently depending on the country and are typically determined by factors such as size. According to Abor and Adjasi (2007), the definition of SMEs in literature varies across countries and authors, usually based on revenue, assets, or number of employees falling below a specific threshold. SMEs significantly impact the economy, especially in developing countries, playing a major role in global business and serving as a key driver of employment and economic growth (World Bank, 2019). The significance of corporate governance has increased, showing advantages for organizations in attracting and retaining investor interest and accessing capital. While large and listed companies have long been regulated to adopt corporate governance practices, the relevance of business size in corporate governance adoption has become less critical. Despite corporate governance standards being traditionally associated with larger corporations, SMEs are increasingly expected to implement corporate governance practices. As corporate governance has become crucial for companies, it has also become indispensable for SMEs, offering various benefits and influencing SME growth. Effective corporate governance is essential for SMEs to ensure ethical and efficient operation, thereby creating value for stakeholders.

The study focuses on SMEs listed on the LEAP (Leading Entrepreneur Accelerator Platform) Market. Launched by Bursa Malaysia in 2017, the LEAP Market provides eligible SMEs a platform to access capital with minimal compliance costs. Operating with enabling regulations, this market allows SMEs to enhance visibility and raise funds from sophisticated investors as defined by the Capital Markets and Services Act 2007 (Bursa Malaysia, 2024). By functioning as an intermediary market, the LEAP Market paves the way for SMEs to access larger funding opportunities in markets like the Main and ACE Market.

Smaller businesses often receive less attention in corporate governance discussions than larger corporations (Ritchie & Richardson, 2004). Despite being associated with short organizational life, difficulties in achieving sustainable growth, and several management challenges, it is crucial for SMEs to establish a robust governance structure to survive and thrive (Günay & Apak, 2014). The board of directors plays a vital role in governance, serving as a key mechanism to ensure that management prioritizes shareholders' interests (Beiner et al., 2004). Since the significance of the board as a governance mechanism varies across organizations (Baysinger & Butler, 1985), understanding the composition of the board in SMEs is essential. This study aims to provide insights into the corporate governance framework and practices among SMEs listed on the LEAP Market of Bursa Malaysia while exploring the current adoption of governance systems crucial for enhancing performance and sustainability in this sector.

This study focuses on governance aspects outlined in Principle A of the Malaysian Code on Corporate Governance (MCCG) 2021. Principle A offers guidelines for companies to establish a high-performing and effective board. The 2021 code maintains the recommendation to separate the chairman and CEO roles as outlined in Practice 1.3 and reinforces recommendations on board composition. Notably, under Practice 5.4, the code emphasizes the significance of independent directors, suggesting that companies consider their tenure and appointment processes, especially for long-serving independent directors. Additionally, Practice 5.5 of Principle A promotes gender diversity by advocating for increased female participation on boards.

Our findings suggest that SMEs listed on the LEAP Market of Bursa Malaysia are increasingly adopting sound governance practices in line with the MCCG recommendations. These SMEs generally prefer smaller board sizes to suit their operational needs. While most appoint at least one independent director, external directors are not commonly included. The emphasis on gender diversity is evident, with half of the companies appointing at least one woman to their boards. Moreover, most of these SMEs have opted to separate the chairman and CEO roles, aligning with the MCCG's guidelines.

This study makes three key contributions. First, it sheds light on the corporate governance practices of LEAP Market companies, a relatively underexplored group. Second, it contributes to the existing knowledge on corporate governance in Malaysian SMEs by offering a current assessment of their governance structure in relation to Principle A of the MCCG 2021. Third, it identifies specific areas where SMEs can enhance their board composition and structure to better align with leading governance practices. The following sections are organized as follows: a review of the literature on board composition in the next section, the methodology of the study in Section 3, data presentation and results in Section 4, and finally, a discussion of the findings and concluding remarks in Section 5.

Literature Review

In many studies on corporate governance, analysis of corporate governance effectiveness often focuses on the board of directors (Iturralde et al., 2016). Regardless of the corporation's size and industry, the board of directors plays a crucial role in determining its performance (Alqatan et al., 2019). Therefore, reviewing relevant literature to discuss governance in SMEs is essential. This research examines the key components of the board as outlined in the Malaysian Code on Corporate Governance (MCCG) 2021, including board size, the appointment of independent and external directors, the inclusion of female directors, and CEO duality.

Board Size

The term "board size" refers to the number of members comprising a company’s board of directors. Determining an appropriate board size is crucial for ensuring effective corporate governance. Although specific laws and governance codes do not specify the exact number of board members, it is generally believed that selecting the optimal board size would be advantageous for the company. Bennedsen et al (2008), highlighted the importance of SMEs finding the right balance. For most SMEs, this typically entails having a board consisting of three to five members. Eisenberg et al (1998), suggest that the ideal board size may vary according to the business's size. Board size is a key aspect related to the oversight and management of a company. Arguments supporting the ideal board size vary and are based on different factors. A larger board is viewed favourably as it is better suited for overseeing and managing a company's operations (Kiel & Nicholson, 2003). However, in the case of SMEs where rigorous oversight is not necessary, the decision to have a larger board may be less effective and challenging to coordinate (Afrifa & Tauringana, 2015). Yermack (1996), argued that capital markets value companies with smaller boards more highly, intimating that limiting board size could enhance efficiency (John & Senbet, 1998). A smaller board allows SME owners to more effectively guide their organization towards its goals (Dixit et al., 2024). While SMEs tend to have small boards due to resource constraints (Parsa et al., 2007), it is expected that board size will increase as the firm expands and goes public, serving as a sign of good governance (Palacín-Sánchez et al., 2019).

Outside Director

The term "outside director" is often used interchangeably with "non-executive director." It is noted that these directors may lack complete independence due to their ownership stakes in the appointing company (Hambrick & Jackson, 2000). Therefore, it is justifiable to distinguish between the two since they serve different functions (Clarke, 2007). The appointment of outside directors is a common practice in corporate boards as stipulated by corporate governance codes. Generally, the majority of board seats are held by outside directors (Fama & Jensen, 1983), who typically have part-time roles with limited involvement in the company's day-to-day operations (Forbes & Milliken, 1999).

In SMEs, outside directors typically include individuals who are not part of the management team or family members or relatives of the CEO (Gabrielsson & Huse, 2005). The inclusion of outside directors in resolving agency conflicts has been suggested (Jensen & Meckling, 1976; Fama & Jensen, 1983), yet concerns exist about their effectiveness due to their knowledge gap compared to inside directors (Bathala & Rao, 1995). Duchin et al. (2010) propose that external directors meet regulatory requirements and significantly impact a company's performance, primarily influenced by their familiarity with the organization. This finding aligns with Mohd Iskandar et al (2017), who suggest that outside directors improve the independence and expertise of the board of directors.

Independent Director

While literature has traditionally grouped outside (or non-executive) directors together with independent directors (Fama & Jensen, 1983; Van den Berghe & Levrau, 2004; Chen, 2011), this study makes a clear distinction between the two. Fama and Jensen (1983) suggested that outside directors should be independent according to agency theory. This theory emphasizes the need for appointing outside directors to ensure the board remains independent from management (Van den Berghe & Levrau, 2004). The introduction of independent directors is seen as a means to resolve agency conflicts stemming from the separation of ownership and control (Arora & Singh, 2020). The notion of independence has evolved beyond just being free from management influence to encompass the absence of any business relationships or other ties that could compromise a director's ability to make impartial judgments or act in the company's best interests. An independent director is not beholden to fostering a positive relationship with management and can address management's faults openly, both within and outside the boardroom, to protect shareholders' interests (Clarke, 2007). The appointment of independent directors is typically seen as a marker of good governance (Brooks et al., 2009) and has a positive association with board and company performance (Uhlaner et al., 2021). These directors are tasked with ensuring that management's actions are in line with shareholder interests (Iturralde et al., 2016). With an increase in the number of independent directors, the board's ability to provide effective oversight can also be strengthened (Chen, 2011).

In the context of SMEs, having independent directors plays a key role in promoting sound corporate decision-making and providing unbiased oversight of management activities (Mohd Iskandar et al., 2017). Integrating independent board members with specific expertise and skill sets enhances the board's credibility and showcases high professionalism (Singh & Pillai, 2022). In the scenario of listed SMEs, the presence of non-executive directors is positively linked to the extent of governance reporting. Their presence is vital as it urges companies to consider the interests of all stakeholders, rather than solely concentrating on shareholders (Parsa et al., 2007).

Women on Board

In accordance with government policies and goals, companies, including SMEs, are increasingly considering appointing women to corporate boards. The inclusion of women directors can have a positive impact on board decision-making. They bring varied experiences, expertise, and values that can enhance the breadth of information considered, leading to more thoughtful decision-making processes (Post & Byron, 2015). As a result, having women on the board is anticipated to yield favourable organizational outcomes (Arora & Singh, 2020). While the presence of women directors has been linked to improved profitability and performance (Burke, 2000; Lückerath-Rovers, 2013), some studies suggest that the influence may be inconsequential (Carter et al., 2010; Chapple & Humphrey, 2014). Hence, careful consideration should be given to the decision of appointing a woman director, with emphasis placed on qualifications and experience to prevent potential adverse effects on the company's financial performance (Shehata et al., 2017). Such decisions should be based on economic rationale rather than emotional factors (Teixeira & Carvalho, 2024).

CEO Duality

CEO duality, where the CEO also holds the position of chairman of the board, is a significant topic in corporate governance discussions. Even predating corporate governance reform, Rechner (1989), put forth that the optimal board governance structure should comprise a majority of external directors with an independent director serving as chairman. The chairman is expected to fulfil multiple roles in leading the board (Lechem, 2003), with their leadership behavior heavily influencing board effectiveness (Machold et al., 2011). Despite the general preference for segregating the roles of CEO and chairman, CEO duality is more common in small businesses due to their distinct characteristics and concentrated ownership (Machold et al., 2011; Iturralde et al., 2016). An organization's decision regarding CEO duality might be shaped by its size and the challenges it encounters (Kiel & Nicholson, 2003), and the consequences of this practice can vary based on the circumstances (Elsayed, 2010).

Research conducted by Mohd Iskandar et al (2017), indicated that in SMEs, CEO duality can aid in reducing administrative and decision-making costs. This focus on cost-saving is crucial for the company's long-term sustainability and future expansion. Furthermore, CEO duality provides a clear vision under a single leader, facilitating swift responses to external conditions (Boyd, 1995). This consolidation of roles can enhance business performance (Li et al., 2022) and boost decision-making efficacy (Dixit et al., 2024).

Methodology

This study investigates the adherence of board composition in SME companies listed on Bursa Malaysia to the corporate governance guidelines set forth by the Malaysian Code on Corporate

Governance (MCCG) of 2021. The research employs a descriptive analysis to evaluate the current level of corporate governance, specifically focusing on board composition. This methodology combines desk-based research with the synthesis of existing literature and secondary data sources. A review of SME corporate governance literature is conducted, followed by a content analysis of published materials and information about SMEs' corporate governance practices. Initially, a review of corporate governance literature in SMEs is performed to identify key characteristics. Subsequently, content analysis is undertaken, a method used to analyse data that may be relatively unstructured by examining symbolic meanings, explicit contents, and communicative roles within the data sources (Krippendorff, 2004, p. 44). The analysis covers the entire population of Malaysian SMEs listed on the LEAP Market of Bursa Malaysia. As of January 2024, this market consists of 51 companies (Bursa Malaysia, 2024), with three companies being excluded due to overlap. The study relies on corporate governance data sourced from company announcements to Bursa Malaysia, as well as information memorandums concerning proposed share replacements and listings on the LEAP Market, and data from company websites. This methodology is crucial due to the limited availability of information regarding the corporate governance practices of SMEs, particularly private SMEs. Additionally, because LEAP Market companies are not mandated to adhere to the MCCG of 2021 as per the Bursa Malaysia Listing Requirements, integrating data from these various sources becomes imperative to maximize the information available.

Results

The descriptive analysis delves into the corporate governance practices of SMEs, with a specific emphasis on board composition, as noted in the literature. The analysis begins by outlining the total number of companies listed on the LEAP Market from its establishment in 2017 to 2023. The study scrutinizes three fundamental elements of board composition within these SMEs: the breakdown of board size, board composition, and the categorization of chairpersons throughout the given timeframe.

Distribution of Listed SMEs on the LEAP Market

The number of SMEs listed on the platform has shown consistent annual growth, indicating a rising interest among SMEs in utilizing this platform for expanding and advancing their businesses. The market was initiated with only two companies listed in its first year. A substantial surge in interest was noted in 2019 when 14 companies joined the market, marking an increase in engagement two years after its inception. In 2021, a significant boost was observed with 12 new SMEs entering the market, followed by a decline in 2022 where only one company was listed. However, in 2023, there was a modest recovery with five new listings. Table 1 presents a summary of the growth in this business segment and its improving capacity to meet the listing criteria of the LEAP market.

Table 1
Summary of listed SMEs growth based on year admission

Year	Total companies	Percentage (%)
2017	2	4
2018	8	17
2019	14	29
2020	6	13
2021	12	25
2022	1	2
2023	5	10
Total	**48**	**100**

Source: Bursa Malaysia

Board Attributes
Assessing the composition of boards in SMEs is vital as it mirrors the company's governance framework. In the case of SMEs listed on the Leading Entrepreneur Accelerator Platform (LEAP Market), boards usually comprise three to seven members, with the optimal size typically falling between three to five members. From the data presented in Table 2, it is evident that 40% of these companies lean towards a smaller board size with only three members, 33% choose to have four board members, and 25% prefer a board of five members. While a larger board size is generally less favoured, it is worth noting that one organization has assembled a board of seven members, displaying a willingness to extend the board size beyond the customary range.

Table 2
Distribution of board size

Board size	Total companies	Percentage (%)
3	19	40
4	16	33
5	12	25
7	1	2
Total	**48**	**100**

Source: Company's information memorandum to proposed placement of shares in conjunction to proposed listing in the LEAP Market, company's website and recent company's announcement to Bursa Malaysia

The study expands its investigation by examining the composition of board members in SMEs. Table 3 illustrates the board composition in the sample, including outside directors, independent directors, and women directors. The data reveals that 52% of SMEs (25 companies) have chosen not to include outside directors on their boards. In contrast, 35% (16 SMEs) have appointed at least one outside director, with six companies having two external directors, and one company having as many as four external directors.

The results show that over 60% of SMEs listed on the LEAP Market have appointed at least one independent director. However, a significant portion (25%) of these SMEs do not prioritize the inclusion of an independent director on their boards. Nevertheless, 14% are open to appointing up to four independent directors, highlighting diverse approaches to board independence among SMEs.

Table 3
Board composition

Board composition	Proportion		Total companies	Percentage (%)
Outside director (non-independent)	None	0	25	52
	Minimum	1	16	33
		2	6	13
	Maximum	4	1	2
Independent director	None	0	12	25
	Minimum	1	29	60
		2	5	10
		3	1	2
	Maximum	4	1	2
Women on board	None	0	20	42
	Minimum	1	21	44
	Maximum	2	3	6
	No data		4	8

Source: Company's information memorandum to proposed placement of shares in conjunction to proposed listing in the LEAP Market, company's website and recent company's announcement to Bursa Malaysia

The statistics regarding female directors highlight the increasing importance of SMEs focusing on including women in their board positions. Despite this, 20 companies (42%) have not complied with the suggestion to improve board diversity by appointing more women. Meanwhile, 21 companies (44%) have taken steps forward by appointing at least one female director to their board. Interestingly, three companies have appointed up to three women to their board of directors. Gender data for the directors of the remaining four companies is currently unavailable.

Table 4
Distribution of chairman based on category

Category of chairman	Total companies	Percentage (%)
Independent non-executive	12	25
Non-independent non-executive	9	19
Executive	11	23
No data	16	33
Total	**48**	**100**

Source: Company's information memorandum to proposed placement of shares in conjunction to proposed listing in the LEAP Market and the company's website and company's announcement to Bursa Malaysia

Aside from the various types of directors appointed to the board, CEO duality stands out as another important aspect of corporate governance. Table 4 sheds light on this practice within companies listed on the LEAP Market. It reveals that 33% of the companies did not provide any information regarding the chairman. Conversely, 44% of these SMEs have adhered to the recommended corporate governance structure by separating the chairman and CEO roles, appointing a non-executive director as chairman. Within this category, 12 SMEs have designated an independent non-executive chairman, while 9 have selected a non-independent non-executive director for the role. Roughly 23% of SMEs have chosen to have an executive chairman, with the remaining 33% not providing any information on this governance aspect.

Discussion and Conclusions

This study examines the extent to which SMEs, particularly publicly listed ones, have implemented the recommendations of the Malaysian Code on Corporate Governance (MCCG) 2021 regarding board composition. The increasing economic importance of SMEs highlights the necessity for these firms to adopt strong corporate governance practices to bolster their resilience and sustainability.

Our evaluation of 48 SMEs listed on the LEAP Market indicates that their CG practices are still limited and inadequate. This outcome aligns with Singh and Rastogi (2023), who promote strengthening the corporate governance framework for publicly listed SMEs. Nonetheless, SMEs on the LEAP Market are progressively moving towards embracing good governance practices, despite facing various limitations, notably in terms of funding and resources. A practical initial step towards establishing robust governance standards involves comparing and assessing the practices of larger publicly listed companies to incorporate their best practices as benchmarks for future employees and investors (Barroso-Castro et al., 2020).

One of the most crucial corporate governance mechanisms is determining the board composition upon initial listing. Our findings indicate that the board size of SMEs on the LEAP Market, though small, is ideal, particularly for minimizing issues related to ineffective board functions and coordination (Arora & Singh, 2020). A smaller board enables SMEs to be more agile and resource-efficient, promoting an environment conducive to innovation and ensuring long-term success (Dixit et al., 2024). Although the average board size is less than that reported in previous studies (Afrifa & Tauringana, 2015; Arora & Singh, 2020; Barroso-Castro et al., 2022), it is expected that the board size will increase as a sign of sound corporate governance (Palacín-Sánchez et al., 2019). Regardless of the number of directors appointed, SMEs must determine the optimal board size, striking a balance between the advantages of diverse skills and expertise and the potential risks of increased opportunistic behaviour among directors (Bennedsen et al., 2008). This equilibrium is crucial as most SMEs opt for smaller boards.

The analysis of board of directors is further extended by examining the composition of SMEs' board members. The findings indicate that most SME companies have at least one independent director, influencing the higher percentage of companies without non-independent directors. This trend emphasizes the inclination towards appointing independent directors. Consistent with Arora and Singh (2020), having an independent director on the board plays a crucial role in mitigating conflicts that arise due to the separation of ownership and control. The appointment of women directors also receives significant attention among public SMEs, with studies noting the benefits of such appointments

(Lückerath-Rovers, 2013; Arora & Singh, 2020). Furthermore, the results suggest a growing trend among publicly listed SMEs in separating the chairman and CEO roles. While CEO duality is common and can offer specific advantages in SME contexts (Iturralde et al., 2016; Li et al., 2022; Dixit et al., 2024), the majority of these companies opting to separate the roles is likely to enhance checks and balances as they transition to listed entities (Abor & Biekpe, 2006).

Although this research is descriptive and limited by availability of data on SMEs' corporate governance practices, it offers valuable contributions in several key areas. This study adds to the growing body of literature on corporate governance in small and medium-sized enterprises (SMEs) by specifically examining the implementation of the Malaysian Code on Corporate Governance (MCCG) 2021 among SMEs listed on the LEAP Market. The findings provide insights into the unique governance challenges faced by SMEs, particularly in balancing board composition, resource constraints, and the adoption of good governance practices. The study further contributes to the theoretical understanding of board composition's role in shaping governance practices in SMEs, emphasizing that optimal board size and the inclusion of independent directors are critical governance mechanisms that can reduce agency conflicts, improve decision-making, and enhance corporate governance quality in smaller firms.

Moreover, this research expands on existing theories related to corporate governance by illustrating that SMEs, while limited in size and resources, can still make significant strides toward robust governance practices. The study bridges the gap between governance theories, often applied to large firms, and the realities of smaller, publicly listed enterprises, particularly in emerging markets like Malaysia. It also demonstrates that the flexibility of smaller boards, coupled with independent oversight, can foster innovation and resilience, reinforcing Dixit et al (2024) arguments on agile governance.

From a contextual perspective, this research focuses on Malaysian SMEs listed on the LEAP Market, providing a nuanced understanding of how these enterprises are progressing toward adopting the MCCG 2021 recommendations. The study highlights the gradual shift toward good governance practices in the Malaysian SME sector despite the limitations posed by resource and funding constraints. Given the economic significance of SMEs in Malaysia and their potential for growth in public markets, this context is especially critical.

Furthermore, by comparing the governance practices of SMEs to larger, publicly listed firms, the study offers practical insights for SMEs aiming to improve their governance structures as they transition to larger markets such as the ACE or Main Market of Bursa Malaysia. The research identifies key areas where Malaysian SMEs can focus their efforts, such as board composition, the separation of chairman and CEO roles, and the inclusion of women directors, to strengthen their governance frameworks. These contextual insights are valuable for policymakers, regulators, and SME owners in shaping future governance strategies that align with both local and global standards.

Nevertheless, this study has a few limitations. Firstly, the findings do not represent the entire population of listed companies but rather a small, homogeneous group of SMEs listed on Bursa Malaysia. Secondly, the study relied mainly on secondary data. Finally, the analysis is limited to descriptive statistics as the study's primary aim is to reveal the extent of corporate governance adoption among listed SME companies. Future research should address these limitations and expand similar studies within a broader SME context.

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