

## **CAN INDEPENDENT DIRECTORS PREVENT ABUSIVE RELATED PARTY TRANSACTIONS?**

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### **Abstract**

Abusive related party transactions (RPTs) have been highlighted as one of the major concerns after the 1997 Asian financial crisis. Since the crisis, many reforms to the law and regulation systems have been taken by the Asian countries, including Malaysia, to curb abusive RPTs. A key problem with RPTs is that the transactions are influenced by the relationship between parties involved in the transactions. Many abusive RPTs cases in Asia, such as Satyam Computers Ltd (India), Transmile Group Berhad (Malaysia), Asia Pulp and Paper (Indonesia) and others, demonstrate how these transactions ultimately benefited the top management and controlling shareholders. Therefore, an area of concern with regard to this issue is a mechanism that can constrain the insiders from engaging in abusive RPTs. Many jurisdictions have placed greater reliance on the institution of independent directors (INEDs) to protect the interest of shareholders. INEDs, being independent from the influence of the insiders, are expected to balance and limit the strong power and incentives of managers and controlling shareholders, thereby effectively prevent abusive RPTs. However, prior studies provide mixed results on whether INEDs are effective monitors. We argue that for INEDs to function effectively, it is not enough just to be independent. Certain INEDs attributes, namely the composition of INEDs, their financial expertise, length of service (INEDs tenure) and the presence of women INEDs, will influence INEDs' governance effectiveness. Therefore, this paper aims to review the role of INEDs in monitoring RPTs. It firstly discusses on the issues surrounding RPTs. Further, this paper reviews the regulatory and corporate governance reforms relating to RPTs and the institution of INEDs, with specific attention to the Malaysian context. Based on prior literature, this paper then highlights on how INEDs composition, financial expertise, INEDs tenure and the presence of women INEDs can enhance their monitoring role. The final section concludes the paper.

**Keywords:** Related party transactions, Independent directors, Directors tenure.