Asian Corporate Governance Association (ACGA)

"Corporate Governance in Asia: Overview and Trends"

Presentation by
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at
Fidelity Investment Management (HK)
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Hong Kong

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Agenda

1. Regulatory, market and corporate trends over 5 years in Asia
2. Macro-economic weakness: a key catalyst for regulatory reform
3. Country rankings
4. Enforcement highs and lows
5. Emerging shareholder activism in Asia
6. Mid caps on a mission

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1. Regulatory trends

1. Significant focus on developing and modernising codes of best practice, listing rules, regulations and securities/company laws over past 5 years.

2. A marked “convergence” towards global best practices (derived mostly from US and UK norms). But superficial, since significant differences remain in legal systems and thinking. Harmonisation an issue.

3. A plethora of new rules, yet some obvious omissions—especially with regard to shareholder rights.

- Logic: “Market liberalization requires more regulation, not less, as markets expand.” Scott Jacobs, MD, Jacobs and Associates. (www.regulatoryreform.com)

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Before the Crisis: Jan 1997

Country	Official code of best practice?	"Independent directors" required?	Audit committees required?
China			
Hong Kong	Yes	Yes	
India			
Indonesia			
Japan			
Korea			
Malaysia		Yes	Yes
Philippines			
Singapore		Yes	Yes
Taiwan			
Thailand			

Source: ACGA research

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Today: April 2005

Country	Date of main code (s)	"Independent directors" required?	Audit committees required?
China	2002	Yes	Yes
Hong Kong	1993/2004	Yes	Yes
India	1999	Yes	Yes
Indonesia	2001	Yes	Yes
Japan	2004	Optional	Optional
Korea	1999	Yes	Yes (large firms)
Malaysia	2001	Yes	Yes
Philippines	2002	Yes	Yes
Singapore	2001/2005	Yes	Yes
Taiwan	2002	IPOs only	Encouraged
Thailand	1999	Yes	Yes

Source: ACGA research

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Market trends

1. Increasing pressure from institutional investors and securities analysts for much greater disclosure of financial data and corporate strategy, plus improvements in shareholder value (eg, buybacks, dividends).

2. Emergence of shareholder engagement and activism. “Engagement” more among institutional investors. “Activism” has been mostly at the retail level, but the picture is changing.

3. Growing intensity of “creditor activism”.

4. Development of CG ratings and surveys.

5. Pressure on investment banks and auditors to play a stronger oversight role.

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Corporate trends

1. Palpable shift in corporate attitudes towards governance post-Enron (circa 2002)—more so than post-Crisis.

2. An incremental rise in governance quality among listed companies overall, but sharp improvement among a small number of large caps and aggressive mid caps—for reasons of competitiveness or mindset.

3. Yet range in governance quality among top 40 companies in each market is significant. Need to segment by sector, ownership structure, management style, age of company (sometimes), customer base.

4. Best companies may not be in highest ranked markets.

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2. Macro-economic weakness: a key catalyst

Rules of thumb (for most Asian economies):

1. Level of state and investor interest in corporate governance is most intense during times of crisis/downturns—and vice versa.

2. Investor appetite for risk increases in growing economies and rising markets, irrespective of a country's overall corporate governance quality. (Note: "Investor" here includes strategic and financial.)

3. Macro-economic factors (ie, GDP growth, inflation, employment) have a stronger catalytic effect on government CG policy than the stock market index.

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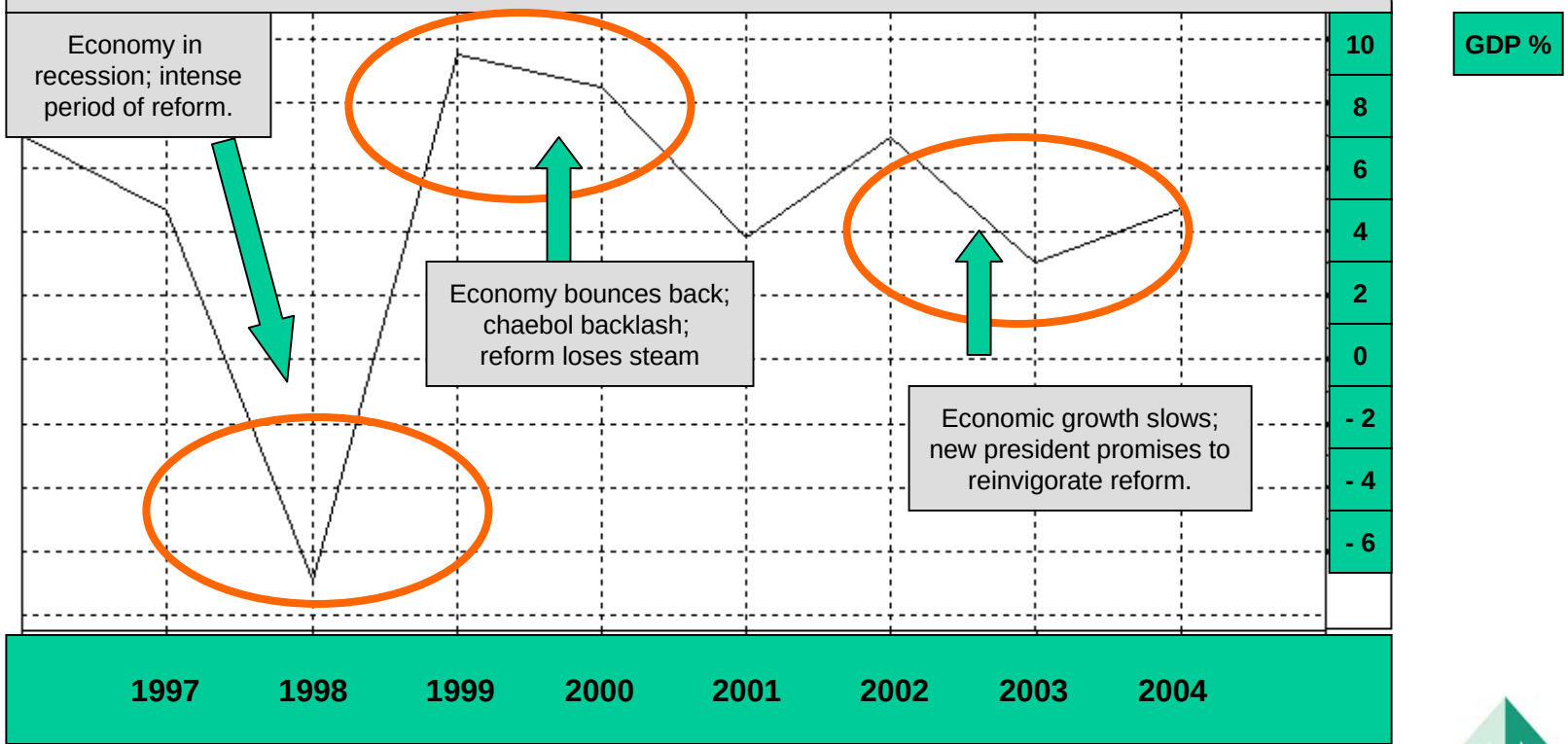
Korean real GDP (1997-2004)

The degree of political will driving corporate governance reform is influenced by macro-economic conditions.



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Korea: Macro-economy & reform trends

- A few corporate-governance initiatives began before the Asian financial crisis (eg, Commercial Code amendments in 1995), but reform largely instigated afterwards and linked to IMF's US$58 billion bailout package (eg, conditions included bank reform, broader CG reforms).
- Reformist presidency of Kim Dae-jung (elected Dec 1997) brought many changes to laws, rules and codes. A major programme of chaebol reform begun to reduce debt, cross shareholdings and connected transactions. Economy in recession.
- Early 2000s: Concerted chaebol backlash against reforms. Economic growth bounces back. Reform loses steam.
- New reformist presidency of Roh Moo-hyun (elected Dec 2002) promises to reinvigorate reforms, but quickly side-tracked by politics (eg, labour disputes) and impeachment. Yet credit card fiasco keeps spotlight on problems within chaebol and some bold moves undertaken (eg, new class-action law).

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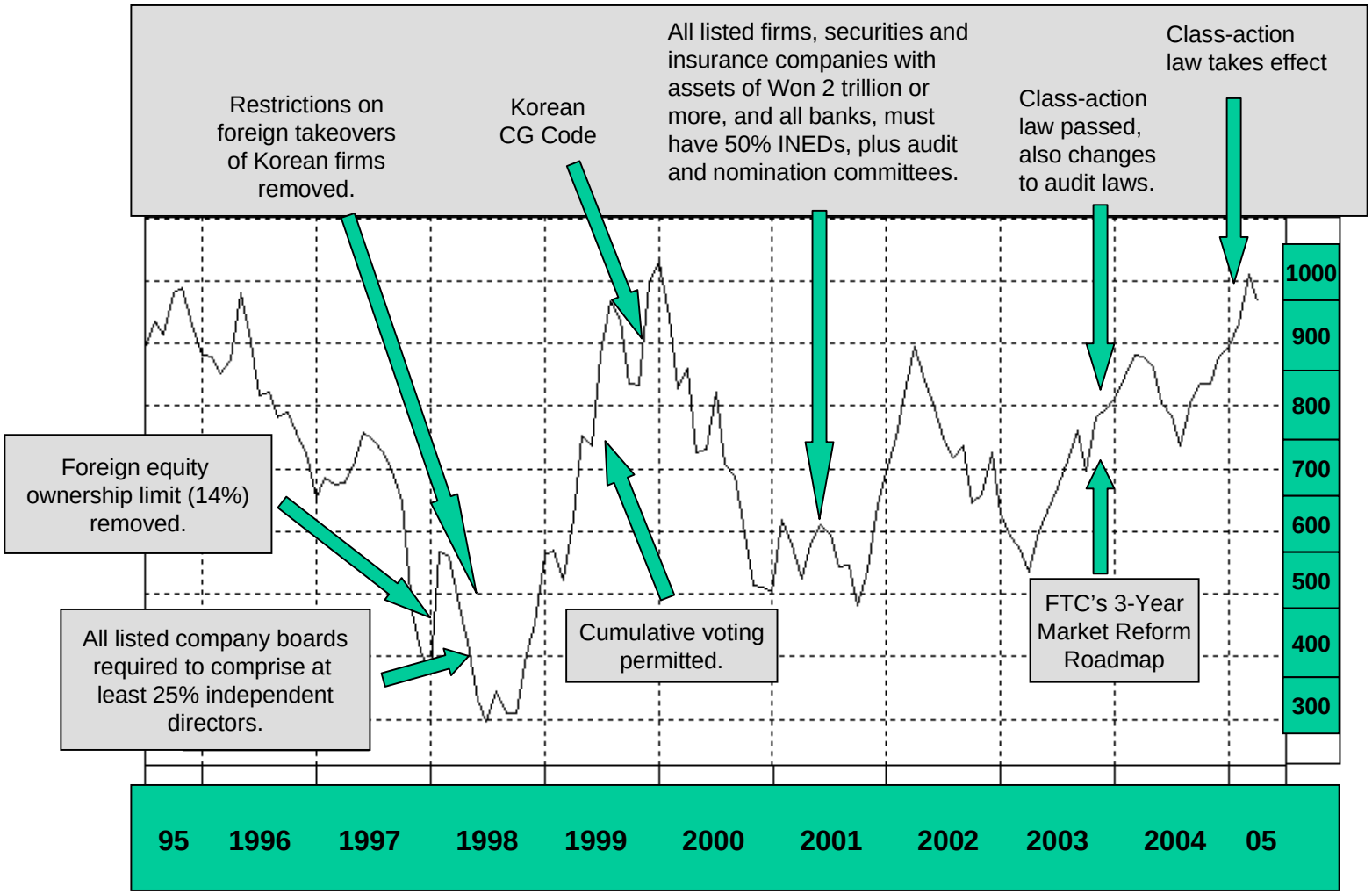
Kospi Index (1995-2005) & CG Reforms



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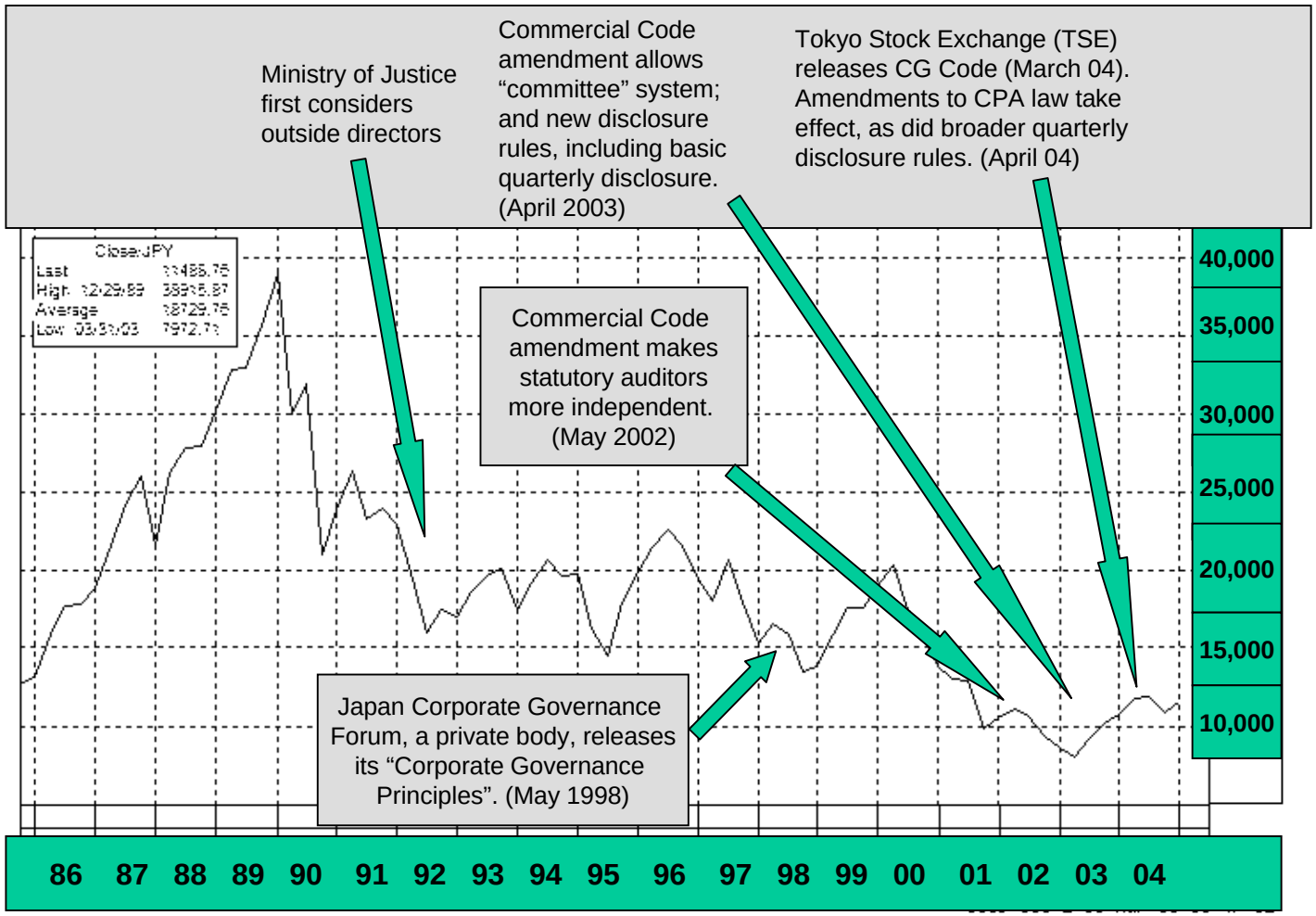
Japan: A study in contrasts
Nikkei Index (1986-2004) & CG Reforms



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Japan: Macro-economy & Reform trends

- The odd-man out in Asia: CG reforms got off to an exceedingly slow start and progress overall has been incremental. (Note: The outside director concept first mooted in Japan by the Ministry of Justice in 1992!)
- An anomaly: Level of state interest remains low despite the country's long period of economic recession/low growth and declining stock markets since the early 1990s.
- Extremely strong business resistance to CG reform *(Keidanren),* much of which is driven by emotion, inertia and refusal to accept that shareholder-value advocates have a point! Despite the recession, many companies are sitting on piles of cash.

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3. Country rankings: "CG Watch"

Country[1]	2000	2001	2002	2003[2]	2004[3]
Singapore	7.5	7.4	7.4	7.7	7.5
Hong Kong	7.1	6.8	7.2	7.3	6.7
India	5.6	5.4	5.9	6.6	6.2
Malaysia	3.2	3.7	4.7	5.5	6.0
Korea	5.2	3.8	4.7	5.5	5.8
Taiwan	5.7	5.3	5.8	5.8	5.5
Thailand	2.8	3.7	3.8	4.6	5.3
Philippines	2.9	3.3	3.6	3.7	5.0
China	3.6	3.4	3.9	4.3	4.8
Indonesia	2.9	3.2	2.9	3.2	4.0

1. Ranked in descending order according to 2004 score. Scores out of 10.
2. First year in which ACGA collaborated with CLSA.
3. Introduced more rigorous scoring methodology in 2004.

Source: "CG Watch", a joint report by CLSA Asia-Pacific Markets and ACGA

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Country components 2004

Country	Rules	Enforce	Pol/reg	IGAAP	CG Culture
Singapore	7.9	6.5	8.1	9.5	5.8
Hong Kong	6.6	5.8	7.5	9.0	4.6
India	6.6	5.8	6.3	7.5	5.0
Malaysia	7.1	5.0	5.0	9.0	4.6
Korea	6.1	5.0	5.0	8.0	5.0
Taiwan	6.3	4.6	6.3	7.0	3.5
Thailand	6.1	3.8	5.0	8.5	3.5
Philippines	5.8	3.1	5.0	8.5	3.1
China	5.3	4.2	5.0	7.5	2.3
Indonesia	5.3	2.7	3.8	6.0	2.7

Source: “CG Watch 2004”, a joint report by CLSA Asia-Pacific Markets and ACGA

Note: Scores out of ten.

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4. Enforcement highs and lows

- Highs:
  - Regulators mostly aware of enforcement weaknesses
  - Some regulators within countries fairer and more effective than others (eg, FTC vs FSS in Korea)
  - Some high-profile prosecutions (eg, Chey Tae-won, Chairman, SK Corp, Korea)
  - Some high-profile delistings (eg, Seibu Railway, Tokyo)
  - Some innovative enforcement practices emerging (eg, Thai SEC “director registration system”)
  - Rules being clarified to make enforcement easier (eg, automatic suspension for late filing in HK)
  - Greater use of fines
  - Some good judicial rulings (eg, Livedoor vs Fuji TV/NBS, Japan)

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Enforcement continued:

- Lows:
  - All regulators are under-resourced, often subject to political influence, and lack sufficient independence
  - Speed of enforcement often excrutiatingly slow (eg, HKEx criticism of HK companies for late filing)
  - Double standards in rules pertaining to director fraud (eg, Korea) lead to illogical and unfair outcomes
  - Enforcement action sometimes driven by politics (eg, JT Kim/Kookmin case in Korea)
  - Fragmented regulatory structures (eg, SFC/HKEx)
  - Politically weak securities commissions (eg, CSRC)
  - Securities commissions often lack support from investigating agencies (eg, Thai SEC vs police/judiciary; Bapepam and public prosecutors in Indonesia)

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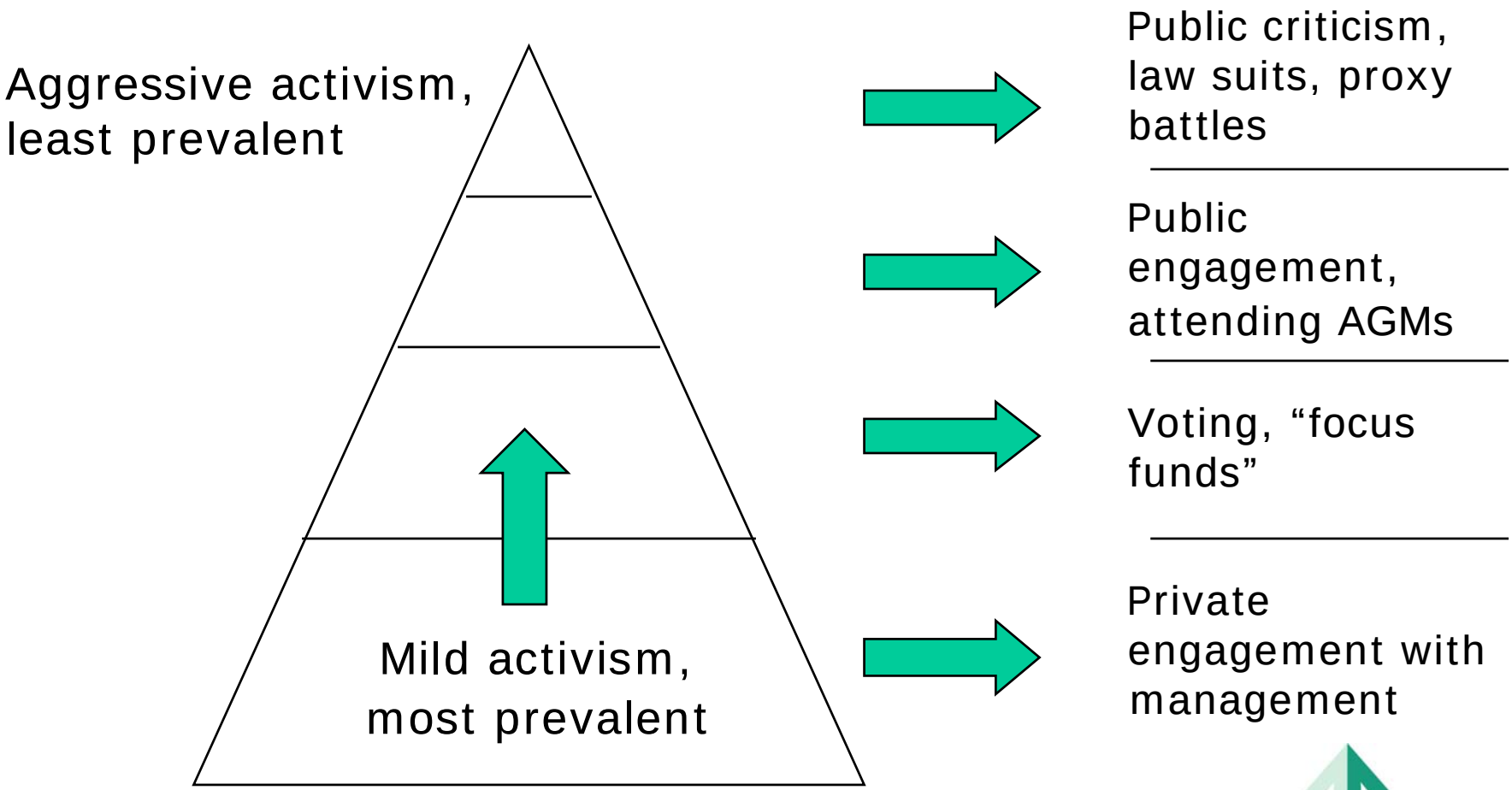
5. Emerging shareholder activism in Asia



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Economic rationale for activism

- "Market-development" rationale: concept of fiduciary duty to clients, building trust and fostering investor confidence; hence deeper, more liquid markets.
- Size of global asset managers: some have become major (minority) investors in Asian listed companies, hence have a greater incentive to engage with those companies.
- Private equity industry: better governance protects your investment, produces better valuations at exit.
- Growth of pension and investment industry in Asia—fiduciary role growing, also leading to ownership changes.
- Unlocking value: some companies sitting on large cash piles.

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Example: Activism & engagement in Japan

- Advanced investment/governance strategies in Japan:
  - **Shareholder activism:** A maverick investor, Yoshiaki Murakami, M&A Consulting Inc, has been taking on companies through proxy battles and media campaigns, seeking disbursement of their huge cash piles through share buybacks, higher dividends, etc.
  - **Private equity:** In 2000 Ripplewood took over the insolvent Long-Term Credit Bank (LTCB) and transformed it into Shinsei Bank. LTCB had been temporarily nationalised in 1998 with US$37 billion in bad loans.
  - **Pension funds:** The Pension Fund Association, which is run by an activist managing director, Tomomi Yano, actively votes its shares and encourages members to do the same.
  - **Value funds:** A number of specialist investment funds have been established, such as the SPARX Japan Value Creation Investment Strategy, to unlock hidden value in companies. CalPERS is one investor in the SPARX fund, launched in Feb 2003.

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Growing in clout: Biggest global investors

Rank	Name	AUM* (US$bn)
1	State Street Global Advisors	1,217
2	Fidelity Investments	1,197
3	Barclays Global Investors	1,150
4	The Vanguard Group	750
5	JP Morgan Fleming AM	747
6	Deutsche AM	700
7	Allianz Global Investors	669
8	Capital Research**	604
9	Northern Trust Global Inv.	527
10	Citigroup AM	491

**Assets under management.*

***A mutual fund company. Capital manages an additional US$289 bn of global institutional funds under a sister company, Capital Group International.*

Source: Global Investor magazine, Dec/Jan 2005.

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The next big thing?

Name	Country	Size (US$bn)
Govt Pension Inv. Fund	Japan	680*
National Pension Corp	Korea	102*
Govt Investment Corp	Singapore	100
Samsung Life Insurance	Korea	69*
Central Provident Fund	Singapore	65
Employees Provident Fund	Malaysia	64
Life Insurance Corporation	India	54*
Temasek Holdings	Singapore	55
National Social Security Fund	China	20
Govt Pension Fund	Thailand	6

Sources: Asian Investor magazine, Feb/March 2004; ACGA research.

**Figures refer to 2003. Other figures from 2004.*

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6. Mid caps on a mission

- For most of the past 5 years, good governance has been most prevalent in the larger, more liquid listed companies in Asia that have an international orientation (though not all of them!).
- An emerging story is the CG focus displayed by some mid caps (eg, in Hong Kong):
  - Voluntary disclosure (eg, quarterly reporting)
  - Quick release of annual results
  - Higher proportion of independent directors than required
  - Focus on internal controls and risk management

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ASM Pacific (522)



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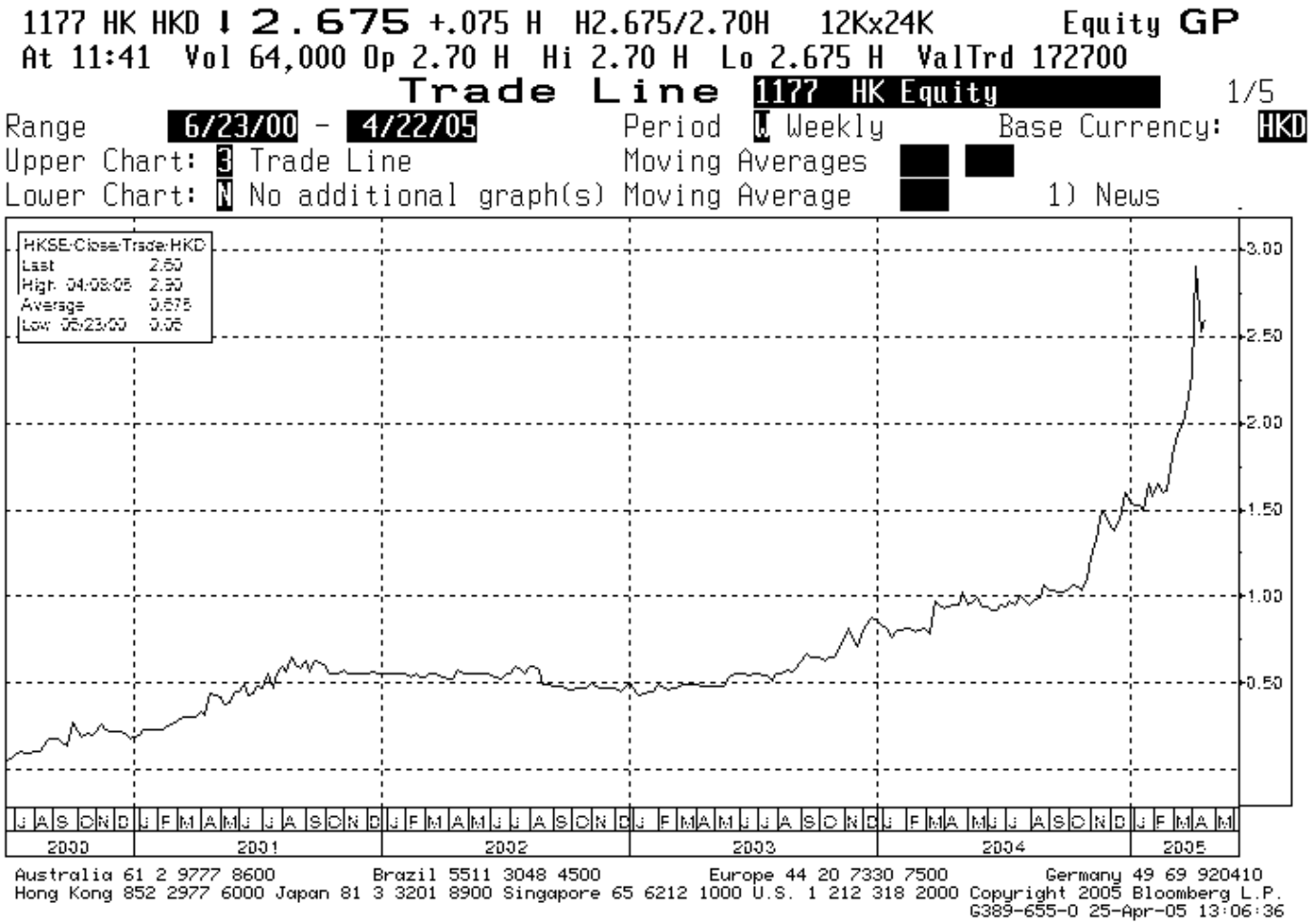
Sino Biopharmaceutical (1177)



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