Asian Corporate Governance Association (ACGA)

"Corporate Governance in Asia: Unravelling the Mystery"

Presentation by:

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Agenda

1. Asian uniformity: formal adoption of CG standards
2. Asian complexity: regulatory & business diversity
3. Ranking of 11 Asian markets
4. Key issues for institutional investors in Asia
5. Company cases
6. Conclusion: Unravelling the mystery

1. Asian uniformity:
Boards before the Asian Financial Crisis of 1997-98

Country	CG Code on board governance?	Independent directors required?	Audit committees required?
China	No	No	No
Hong Kong	Minuscule	No	No
India	No	No	No
Indonesia	No	No	No
Japan	No	No	No
Korea	No	No	No
Malaysia	No	No	No
Philippines	No	No	No
Singapore	No	No	No
Taiwan	No	No	No
Thailand	No	No	No

The shift towards international standards:
Boards after the Asian Financial Crisis

Country	CG Code on board governance?	Independent directors required?	Audit committees required?
China	2002	Yes	Yes
Hong Kong	1993/2004/2012	Yes	Yes
India*	1999	Yes	Yes
Indonesia	2001	Yes	Yes
Japan	Still no consensus	Still optional	Still optional
Korea	1999/2003	Yes	Yes (large firms)
Malaysia	2000/2007/2012	Yes	Yes
Philippines	2002/2009	Yes	Yes
Singapore	2001/2005/2012	Yes	Yes
Taiwan	2002/2011	For IPOs and larger firms	Soon mandatory for larger firms
Thailand	1999/2006	Yes	Yes

2. Asian complexity
Legal and regulatory variation

	Historic basis of company law	Board structure	Minimum # of INEDs
China	German	Dual (two boards) + Party C'tee	One-third
Hong Kong	English	Single	One-third
India	English	Single	33-50%
Indonesia	Dutch	Two-tier	30%
Japan	German	Dual (two "boards")	One INED or ISA[α]
Korea	German/ Japanese	Single or quasi dual	25-50%
Malaysia	English	Single	Majority*
Philippines	American	Single	Two/20%
Singapore	English	Single	One third to majority*
Taiwan	German/ Japanese	Single or quasi dual	Two for certain companies
Thailand	French / mixed	Single	Three/one-third

*Majority suggested only if the chairman is non-independent. Not a mandatory rule.

α "ISA" refers to an independent statutory auditor (kansayaku).

Source: ACGA research

Asian complexity
Corporate ownership and cultural variation

	Dominant form of corporate ownership	State control of large caps?	Strength of family business culture
China	Concentrated	Extensive	Emerging
Hong Kong	Concentrated	Minimal	Strong
India	Concentrated	Some	Strong
Indonesia	Concentrated	Some	Strong
Japan	Dispersed, but control by management	Some	Weaker, but strong groups
Korea	Dispersed, but control by families	Some	Strong
Malaysia	Concentrated	Some	Strong
Philippines	Concentrated	Some	Strong
Singapore	Concentrated	Extensive	Strong among non-state firms
Taiwan	Dispersed, but control by families	Some	Strong
Thailand	Concentrated	Some	Strong

Source: ACGA research

Asia: A stir fry of new and old standards

- Most new CG reform ideas are borrowed, to varying degrees, from outside. There is little regulatory innovation to date in Asia. Indeed, the same is true for the whole concept of the "public limited corporation".
  - North Asian regulators tend to dismiss good ideas from within the region (eg, Hong Kong's rules on related-party transactions; Thailand's tougher approach on corporate criminals.) They want to base their rules on the US or Europe.
  - Southeast Asia is witnessing more cross-border regulatory cooperation and some degree of innovation. Part of its Asian Economic Community integration.

- Much glib admonition against "one size doesn't fit all" on board governance. But all new reforms look largely the same!
  - Most countries have boards of directors shaped from a mix of legacy and colonial regulation with diluted versions of new international standards.

- For investors, the concept of "Asia" is not a meaningful analytical tool in corporate governance.
  - You need to look at countries and then companies, not regional generalities.

Another perspective:
CG reform in Asia is moving on two tracks

1. International rules dominate in areas where common standards are needed, expected and implementable. For example:

   - Accounting and financial reporting standards
   - Shareholder meetings / voting
   - Regulation of external auditors

2. Local norms dominate where regulatory and shareholder influence is limited. For example:

   - Functioning of boards and board committees (as opposed to their structure)
   - Dialogue with shareholders
   - Decisions on related-party transactions
   - Capital-raising exercises

3. Ranking of 11 Asian markets

"CG Watch" total market scores: 2007 to 2012

(%)	2007	2010	2012	Change 2012 vs 2010 (ppt)	Trend of CG reform
1. Singapore	65	67	**69**	(+2)	Improving, but culture needs to open more
2. Hong Kong	67	65	**66**	(+1)	Static, but reinvigorated regulator positive
3. Thailand	47	55	**58**	(+3)	Improving, but corruption a major issue
4. = Japan	52	57	**55**	(-2)	Government stalling, companies opening
4. = Malaysia	49	52	**55**	(+3)	Culture at last showing signs of openness
6. Taiwan	54	55	**53**	(-2)	Rules improving, but still behind the curve
7. India	56	48	**51**	(+3)	Enforcement up, Delhi an obstacle
8. Korea	49	45	**49**	(+4)	Government more open, chaebols closed
9. China	45	49	**45**	(-4)	Rules improve, but culture still weak
10. Philippines	41	37	**41**	(+4)	Improving, but will it be sustained?
11. Indonesia	37	40	**37**	(-3)	Regressing, but new regulator may help

Source: "CG Watch" surveys, Asian Corporate Governance Association & CLSA Asia-Pacific Markets

Total market scores based on five categories

"CG Watch" market category scores

(%)	Total	CG Rules & Practices	Enforcement	Political & Regulatory	IGAAP	CG Culture
1. Singapore	**69**	68	64	73	87	54
2. Hong Kong	**66**	62	68	71	75	53
3. Thailand	**58**	62	44	54	80	50
4. = Japan	**55**	45	57	52	70	53
4. = Malaysia	**55**	52	39	63	80	38
6. Taiwan	**53**	50	35	56	77	46
7. India	**51**	49	42	56	63	43
8. Korea	**49**	43	39	56	75	34
9. China	**45**	43	33	46	70	30
10. Philippines	**41**	35	25	44	73	29
11. Indonesia	**37**	35	22	33	62	33

Source: Asian Corporate Governance Association

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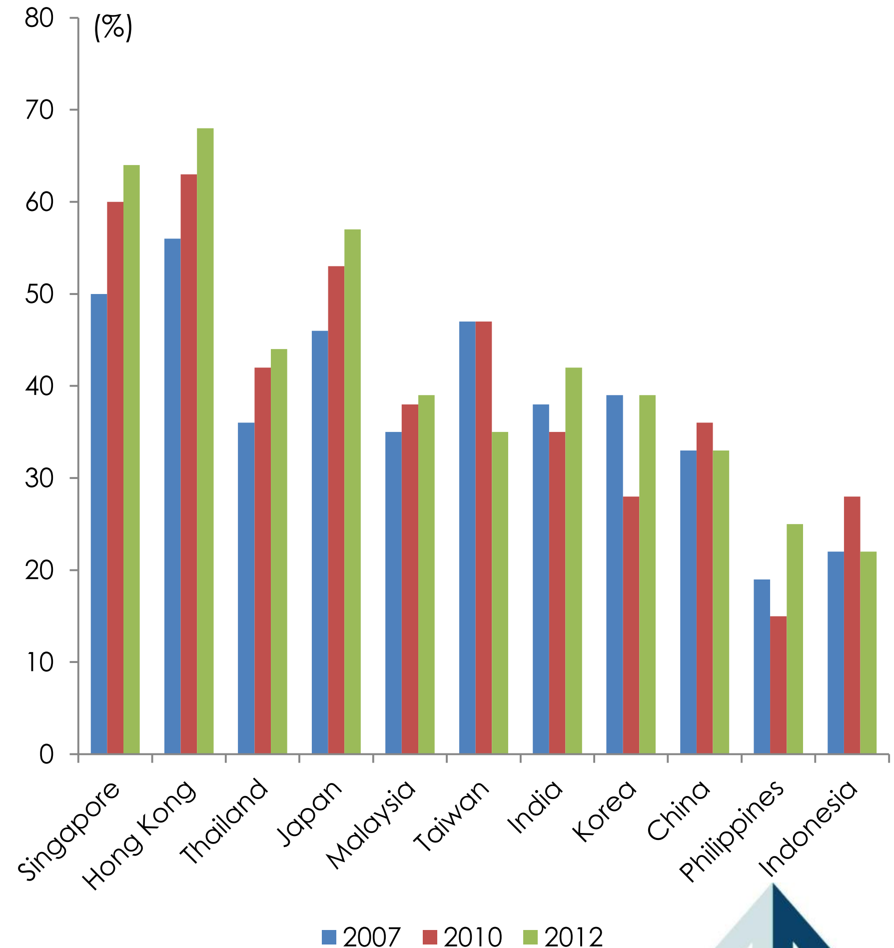
Enforcement

- Higher scores last year in eight of the 11 markets.
- Four of the eight showed a clear rising trend over the previous five years.
- In two of the three markets whose score fell in 2010 before bouncing back last year—namely India and the Philippines—the latest score was higher than its previous high in 2007.
- China's and Indonesia's scores fell because no marked improvement over the past two years and doubts as to whether the regulatory system is fair and consistent.
- Taiwan's score fell significantly in large part due to problems in the area of enforcement data.

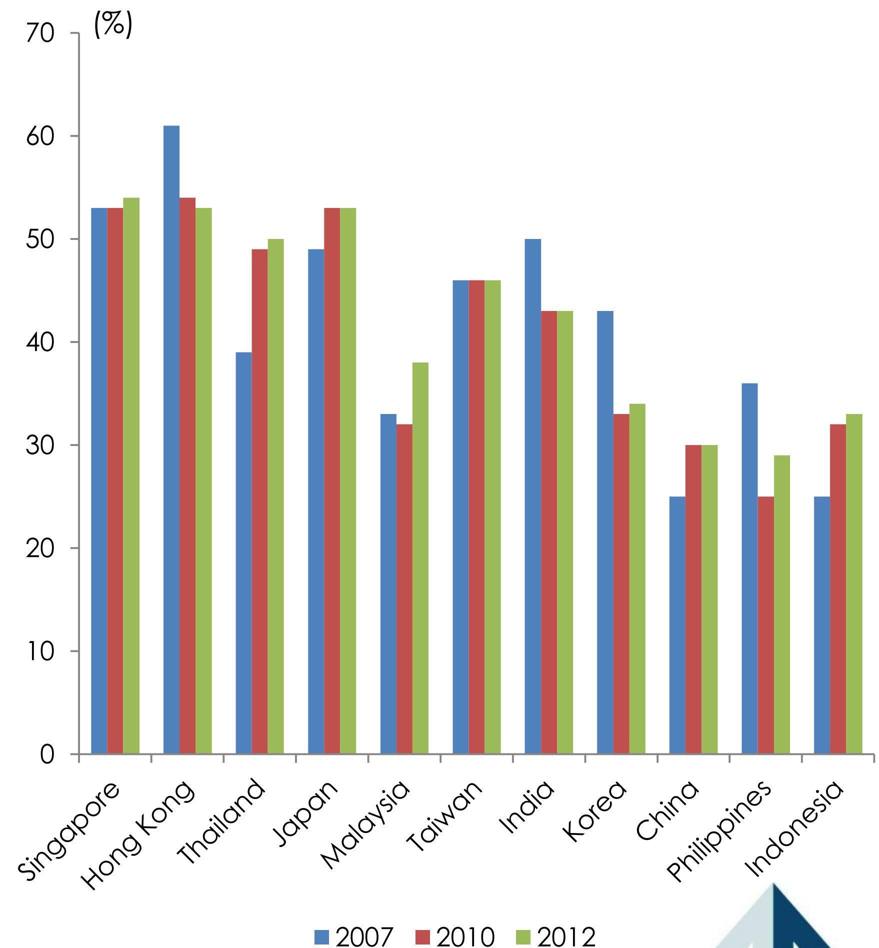
Enforcement: 2007 to 2012



CG Culture

- Few markets stand out for making a great deal of progress on their corporate governance culture.
- What is most striking is that so few markets have shown any improvement in score.
- Six of the 11 are either flat or declining, while three of the remainder recorded only minimal increases.
- While the Philippines showed a noticeable jump, its score is still less than in 2007.
- The only market significantly above 2007 and 2010 is Malaysia, albeit from a low base.

CG Culture: 2007 to 2012



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4. Key issues for institutional investors in Asia

Quantitative

- Financial reporting that is detailed and has integrity. No surprises.
- Immediate disclosure of material events.
- Clarity and controls on related-party transactions—*the* CG issue.
- Strong shareholder rights (eg, approval of major transactions).
- Fair systems of capital raising (ie, no excessive dilution).
- Transparent shareholder meetings, including voting by poll.
- Clarity on executive compensation policies.
- A policy/strategy on sustainability and disclosure of material risks.

Qualitative

- Independent and well-balanced boards.
- Meaningful "non-financial reporting" on internal governance.
- Open shareholder communications.

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5. Company cases – 1

- **Financial mis-reporting / accounting fraud:**
  - Olympus, Daio Paper and AIJ Investment in Japan over 2011-12.
  - Numerous PRC private companies listed in the US through "reverse takeovers".
  - PRC "S-chips" in Singapore and "P-chips" in Hong Kong.

- **Non-disclosure of material events:**
  - All the Japanese companies listed above!
  - Citic Pacific, a PRC red chip in Hong Kong in 2008.
  - MMM, a shipping company in Malaysia.

- **Related-party transactions / conflicts of interest:**
  - Controlling shareholder embezzlement at SK Group and Hanwha in Korea.
  - Bumi plc saga in Indonesia through 2012 and into 2013.
  - Increased royalty payments at Unilever and Holcim in Indonesia in early 2013.
  - Government control of electricity tariffs at KEPCO, Korea. New CEO resigned late 2012.
  - Co-chairmen of Sun Hung Kai in Hong Kong arrested for bribery. (The charges against one, Raymond Kwok, have since been dropped.)
  - China Petrochemical proxy battle in Taiwan in mid-2012.

Company cases – 2

- **Inability to approve major transactions:**
  - Sale of large stake in Olympus to Sony in 2012.
  - All private placements in Japan above 25%.

- **Unfair, dilutive or questionable capital raising exercises:**
  - Hong Kong Exchanges' private placement in late 2012.
  - Sinopec, a PRC state enterprise, in Hong Kong in 2013.
  - Li Ning heavily discounted open offer in Hong Kong in 2013.
  - Yahoo deal with Askul in Japan in mid-2012.
  - Sahara placement in India in 2012.

- **Lack of transparency in shareholder meetings:**
  - Voting by poll is still limited in more than half the countries in Asia, including Singapore, Malaysia, India, Korea, Indonesia, Philippines.

6. Conclusion: Unravelling the mystery

- Asia is highly diverse—avoid regional generalisations; look at country and company specifics. Extent of governance adaptation varies greatly, even within markets.
- New CG reforms in Asia are being grafted onto older systems—international standards have the upper hand where their logic is most compelling and regulatory / shareholder influence is most pronounced. But local norms remain dominant in the internal culture of firms.
- Asia is steadily, if sometimes fitfully, improving its CG. The best in Asia can be good, even if the average is poor. But much reform is top-down, state-driven.
- With the region in transition, institutional investors can have an impact on country and company CG regimes. The more you visit in person, the less of a mystery it becomes!

Please visit if you come to Hong Kong!

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