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Asian Corporate Governance Association (ACGA)

"Assessing Corporate Governance in Asia, 1999-2009: What's in Store for the Next Decade?"

Presentation by
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"Asia's New Market Realities"
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Agenda

1. Lessons learned from 1999-2009
2. What substantive improvements have been made in Asia?
3. What's in store for the next decade?
4. Conclusion

Introducing ACGA

- The Asian Corporate Governance Association (ACGA) was formed in 1999 to support the implementation of effective corporate governance in Asia. Our scope of work covers research, advocacy and educational events in 11 Asian countries.

- ACGA is incorporated in Hong Kong as a non-profit association and is independently funded by a corporate membership base.

1. Lessons learned from the last decade

- In the late 1990s, various arguments were made in favour of better corporate governance. It would:
  - Lower the cost of capital
  - Lead to a stronger share price / higher valuation
  - Protect investors against downside risk
  - Help companies manage risk more effectively
  - Improve market liquidity and investor confidence
  - Minimise risk posed by family and state ownership
- Which ones have stood the test of time?

Test of time – 1

- **Lower cost of capital**
  - Tricky to assess the link between good CG and cost of capital (external factors come into play), but anecdotal evidence suggests that well-governed companies have stronger relationships of trust with shareholders, bondholders and bankers, and enjoy lower capital costs over time.
- **Stronger share price / higher valuation**
  - Again, difficult to prove causality, but correlations tend to prove strongest in downturns. Some anecdotal evidence that new IPOs with good CG tend to sell in the higher end of their price range.
- **Protecting investors against downside risk**
  - There is no question that this is true. Numerous failures in both public and private equity show how poor CG can lead to the destruction of shareholder value.

Application of GMI ratings

- In February 2008, Raj Thamotheram, Director of Responsible Investment, AXA Investment Managers, examined company ratings data from Governance Metrics International (GMI), a New York-based agency, and found that GMI's research indicated that there was "a positive relationship between their scores and a number of financial measures such as earnings growth and return on equity".
- His team found that:
  - "Between 2003 and 2007, companies that were upgraded for CG scores were more likely to outperform the benchmark index and vice versa."
  - "Companies with higher CG scores tended to outperform those with lower scores when the economic backdrop was more uncertain, with lower scored companies outperforming when economic confidence was improving." (Note: This accords with CLSA's research.)
  - "Companies with higher CG scores tended to have lower volatility, lower beta and lower value at risk than those with higher scores."

Source: Pensions World, Feb 2008

Test of time – 2

- **Managing risk more effectively**
  - If implemented well, governance tools such as board committees, structured reporting, a stronger internal audit function and a more robust external audit can help managers better think through the management of different risks.
- **Improved market liquidity and investor confidence**
  - External factors affect liquidity, but markets with better governance (HK, Singapore) do have stronger liquidity over time than those without (Philippines, Indonesia). Outliers include China and India.
- **Minimising family and state ownership risk**
  - Greater transparency and accountability does reduce risk of investment in family firms and SOEs, but the same applies to any company. Quality of CG in family firms and SOEs varies greatly, hence need to draw distinctions and differentiate. But succession planning can be very problematic for family firms.

Other lessons learned

- "Form vs substance": A superficial debate that misses a key point—both form and substance matter. Form usually comes first.
- "Shareholders vs stakeholders": Another overly simplistic debate—good stakeholder management enhances firm value over time (which is good for shareholders).
- "CG is bad for entrepreneurs": But entrepreneurs also have to manage risk and reputation! CG tools can help them do this, make better strategic decisions and prepare for IPOs.

Higher standards are good, not bad, for markets

HK's market has grown throughout the past decade of CG reform

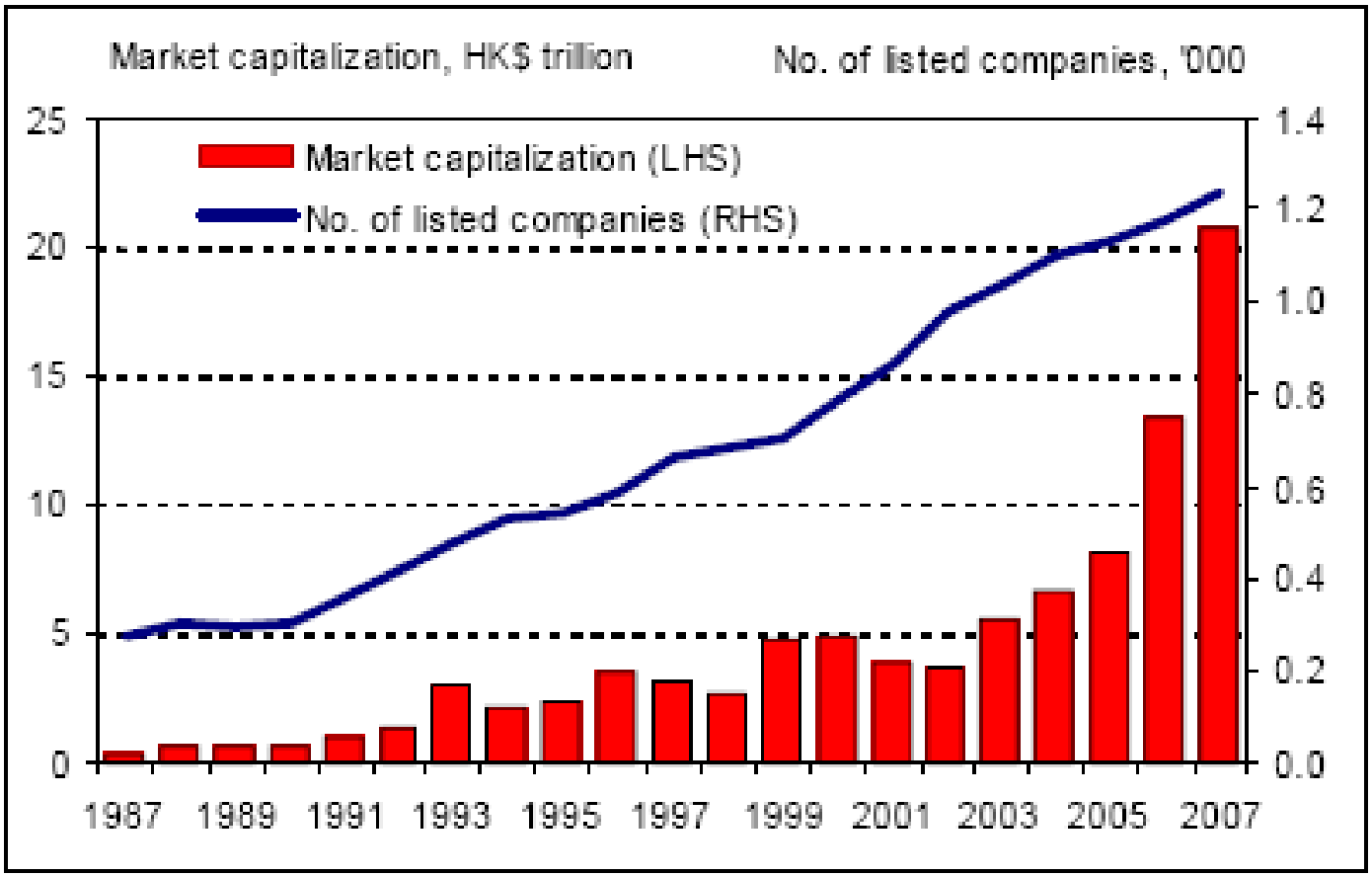


*Chart taken from Bauhinia Foundation report, 2008.

2. Substantive improvements in Asia

Looking generally around the region, what you see is...

Area	Improvements
Financial Reporting	More detailed disclosure rules; faster reporting; quarterly reporting; disclosure of "material" events, director pay, director dealings.
Board composition and function	Introduction of independent directors, board committees, director training; higher expectations placed on directors; higher fees paid to directors.
Shareholder rights	Formal rights strengthened; retail activist groups formed; institutional investors started voting their shares and taking engagement more seriously.
Accounting / auditing	Local accounting standards brought more into line with international standards (ditto auditing standards); independent regulation of audit profession in some markets.
Regulatory enforcement	Financial regulators still under-equipped, but there has been more focus on enforcing listing rules and key securities laws (eg, insider trading).

3. What's in store for the next decade?

- Broad areas where change will occur:

  1. Regulatory regimes
  2. Board development
  3. Shareholder rights
  4. Stakeholder issues

Regulatory regimes

- Regulatory regimes undergo continual evolution:
  - **Securities laws / enforcement:** Continued (and hopefully stronger) focus on insider trading, fraud, market manipulation, related-party transactions.
  - **Company law:** More focus on director duties, organisation of annual shareholder meetings, legal remedies for shareholders.
  - **Listing rules:** Statutory backing for listing rules where this does not exist (eg, Hong Kong), voting by poll at shareholder meetings.
  - **Auditing:** Stronger and more independent regulation of the auditing profession.
- But some regimes (China, Japan) will maintain and strengthen local governance practices (eg, relating to boards and management supervision)

Next stage of board development

- Are companies getting the most value from their boards?
  - **Board composition:** More focus on linking board composition to strategic direction and needs.
  - **Board committees:** More thought will be given to the choice of committees, how they operate and what they should achieve.
  - **Independent directors:** A growing recognition that, if selected well and given "voice", they can bring value.
  - **Director expertise:** The word "training" is despised by most directors. Yet a good director is an informed director. Knowledge needs to be updated.

Expanding shareholder involvement

- Companies like to diversify their shareholder base. But are they aware of how rapidly the expectations and behaviour of institutional shareholders is changing?
  - **Proxy voting:** Investors need the earlier release of final AGM agendas if they are to vote in an informed way (28 days). They want their votes properly counted ("voting by poll") and the results published.
  - **"Pre-emption rights":** Large and dilutive private placements to a select group of investors increases risk to other shareholders.
  - **Privatisations/delistings:** Protection for minority shareholders (eg, approval processes) is weak in much of Asia.
- An open dialogue with shareholders is good preventative medicine. Companies do face difficulties in deciding who to "dialogue" with, however.

Stakeholder risks

- Stakeholder communities and issues are fluid and evolving:
  - Among investors, the understanding of "CSR" (corporate social responsibility) is changing and morphing into "ESG" (environmental, social, governance). ESG puts an explicit governance foundation under CSR.
  - Greater focus on the need for investors to incorporate environmental, social and governance risks into the investment process. For example, the United Nations Principles of Responsible Investment (UNPRI).
  - Greater focus on how companies are addressing specific global environmental challenges, such as CO2 emissions.
- Integrating environmental and social challenges into a company's strategy and operations is the name of the game, but easier said than done.

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