BUILDING STRONGER BOARDS AND COMPANIES IN ASIA

A Concise Report on Corporate Governance Policies and Practices

ASIAN CORPORATE GOVERNANCE ASSOCIATION

China • Hong Kong • India • Indonesia • Japan • Korea • Malaysia • Philippines
Singapore • Taiwan • Thailand

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Contents

1. Introduction 1
2. Country overviews 3
   - China 5
   - Hong Kong 8
   - India 11
   - Indonesia 15
   - Japan 19
   - Korea 21
   - Malaysia 25
   - Philippines 27
   - Singapore 31
   - Taiwan 35
   - Thailand 39
3. The Asian Corporate Governance Association 43
   - • Introduction 45
   - • Mission 45
   - • Action Plan 46
   - • Founding Board Members 47
   - • Board Member Biographies 48
   - • Secretariat 52
   - • Fund Raising 52
   - • Founding Sponsors 53

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Introduction

This report provides a snapshot of corporate governance policies and practices around Asia as of early 2000. Who or what are the catalysts for change? What new developments have occurred? What are the main institutional, regulatory or psychological obstacles to reform? These are the core questions that each country overview seeks to address.

What we have found is that Asia does not divide neatly into countries that entirely follow either the Anglo-American corporate model of diversified ownership, single-tier boards, shareholder emphasis and institutional investor activism or the German model of concentrated ownership, two-tier boards, stakeholder focus (ie, inclusion of employees on the supervisory board) and bank or majority owner control. Although the formal structures of Asian companies bear resemblance to these systems, local business practices and legal norms have, not surprisingly, been the main determinants of corporate behavior.

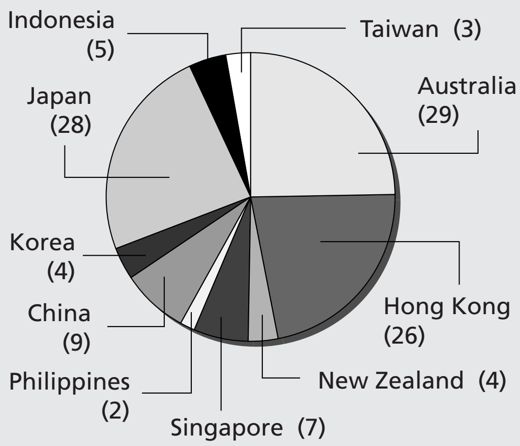
An obvious manifestation of this contrast is the continuation of family dominance over listed and unlisted companies even in places heavily influenced by British law, such as Hong Kong, India and Malaysia. And while family control suggests that Asia may have more in common with Europe than with Britain or the US, countries traditionally influenced by German or Dutch legal thinking, such as China, Indonesia, Japan, Korea and Taiwan, hardly mimic the two-tier model in practice.

Yet, in contrast to this diversity, we have also found that a gradual process of convergence towards the Anglo-American model is underway at the policy and regulatory level in Asia. The main features of this are as follows:

- Many governments, in partnership with business, have developed codes of best practice that reflect common agreement on the need for board independence, stronger shareholder and creditor rights, workable audit committees, and much greater disclosure of information to the market.
- Countries influenced by German law in the past are being influenced by American company law as their firms list on US stock markets and comply with US standards of disclosure (see the chart "Going West"). In some cases, notably China, their regulatory bodies are explicitly studying legislation and practice in the US, the UK, Europe and other parts of Asia, particularly Hong Kong.
- While some countries lean towards a prescriptive approach to reform (China, Korea) and others more towards a voluntary one (Hong Kong, Thailand),

Going West

Number of Asian ADRs in the US

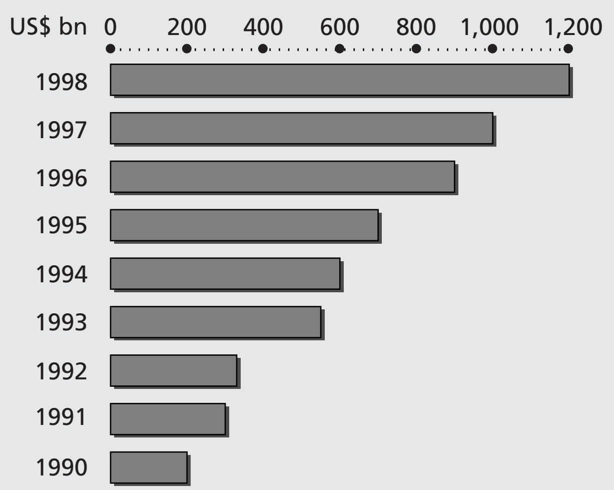


Note: Asian ADRs on the New York Stock Exchange and NASDAQ as of June 15, 1999.

Source: The Bank of New York

The funds keep flowing

Holdings of foreign equities by US investors



Source: Federal Reserve Board; The Bank of New York.

almost all agree that certain minimum standards or principles must be enforced if international investors are to have confidence in their markets. These areas of commonality are likely to expand over time as international investment, especially from the US, increases (see chart "The funds keep flowing").

• It is increasingly accepted that minority shareholders—especially institutional investors—are a critical lever for checking management behavior and enhancing board independence. This has been explicitly recognized not only in Hong Kong, India, Malaysia and Singapore, but also in China, Korea and Japan.

On a practical level, the similarities may become more striking than the ideological differences as a result of economic and political change. A common question is whether the objective of corporate governance reform is to enhance shareholder value or both shareholder value and stakeholder benefits? Governments in China, Japan, Korea and Thailand like to talk explicitly about the responsibility that corporations have to their employees and society at large. Yet successful companies in India and many other parts of Asia recognise this too, while Hong Kong is implementing a mandatory pension scheme for all workers (to which both employers and employees must contribute). Creditors are certainly no worse off in Hong Kong because it lacks a "stakeholder focus" (on the contrary, they are better off than in many other parts of the region precisely because of the city's strong rule of law). And as a result of the Asian crisis, layoffs and unemployment are serious problems throughout the region.

Convergence does not mean that corporate governance reform will be implemented identically in each country. The pace of change will differ depending on a number of factors: extent of government support, strength of the regulator, need to attract international capital, efficacy of the legal system, usefulness of existing checks and balances, and the degree to which companies see corporate governance as in their own interest.

The details of rules and codes will also vary: Should independent directors make up 25% or 50% of the board? What does an "independent director" mean? And how should they be elected or appointed? Are audit and remuneration committees needed? If so, when? Who should train directors? And how much should they be paid?

Family control of listed companies throughout Asia offers a strong challenge—over the medium-term at least—to concepts of board independence, transparency and accountability. But what is striking is the way in which most Asian governments are explicitly or implicitly affirming Anglo-American ideas as the core of their corporate governance systems. Unless globalisation is rolled back (unlikely over the long term), this process of change will surely continue.

Country overviews

Country overview

China

"Management of state-owned enterprises has been allowed to go unchecked because the state has not exercised its rights of ownership properly."

Anthony Neoh, SC, Chief Adviser, China Securities Regulatory Commission
Writing in the *Far Eastern Economic Review*, May 6, 1999.

Introduction

The Chinese government is making a virtue out of necessity. In order to sustain China's economic development, it realizes that it has no choice but to reduce the debt of its near-bankrupt state-owned firms, improve competitiveness and managerial competence, and develop the country's emerging capital markets. To do all this will require a fundamental change in the way state companies are managed (ie, the use of checks and balances). It will also require building entirely new systems of protection for investors and creditors. This is a principal reason why the State Council, China's cabinet, is attracted by the mechanisms of corporate governance.

What is especially noteworthy about China is not simply that it is thinking about these things—China often borrows good ideas from overseas—but rather that there are so many existing and potential points of leverage for corporate reform.

Catalysts for change

The primary institutional drivers of reform today are the State Council (under Premier Zhu Rongji) and the China Securities Regulatory Commission (www.csrc.gov.cn). It is possible that in the near future other bodies will play a part, including the National People's Congress, China's highest legislative organ, and the Supreme People's Court. Leading cities, in particular Shanghai, are becoming laboratories for corporate reform; as are the growing number of major state enterprises listed in Hong Kong and on overseas stock markets like New York, London and Singapore.

This is not all. In recent years, the Chinese press has become quite an effective medium for rooting out corruption in state enterprises. Small Chinese investors are starting, albeit in a very small way, to use the court system to sue negligent companies. And the development of long-term pension funds as part of a social security system is likely to lead to the creation of large domestic institutional investors, as will the expansion of the insurance industry (these funds could act as a check against management).

Cooperation with overseas securities regulators, particularly those in Hong Kong but also elsewhere, is a further source of ideas and expertise. Zhou Zhengqing, chairman of the China Securities Regulatory Commission (CSRC), told an audience in Hong Kong in April 1999 that China had "accumulated good regulatory experience from our contact with these markets". Mr Zhou outlined a set of principles designed to raise the quality of China's publicly listed companies and protect international investors that reads like a what's what of corporate governance reform: regulation of related-party transactions, enhanced transparency, appointment of independent directors, greater board responsibility, and so on. He also said that CSRC and the State Economic and Trade Commission had published a set of governance guidelines for overseas-listed state enterprises "after consulting with relevant overseas regulatory authorities, stock exchanges and practitioners".

New developments

The last 12 months have brought a series of significant regulatory and policy developments, including the new Securities Law on July 1, 1999 (see table on the next page) and a decision to begin separating the government's dual role as owner and regulator of state-owned corporations. The initial plan is to corporatize the 900 largest state enterprises, with a view to public listings in future.

The State Council, meanwhile, has been busy promulgating new regulations that should help to liberalize and develop China's securities markets. For the first time:

- State enterprises are permitted to swap their debt for equity.
- State-owned shares in listed companies can be traded on the market (as long as the state retains control).
- State-owned firms can buy stocks on the primary market (but must hold on to them for three months and not use borrowed money).
- Insurance companies are allowed to invest in mutual funds.
- Licensed foreign insurers are allowed to invest in "A shares" through Chinese mutual funds (previously, foreigners could only trade in the illiquid "B share" market).

Obstacles

A core weakness in China's state-owned enterprise system has been the lack of checks and balances. Too much decision-making power has in the past been concentrated in the hands of the chief executive of each enterprise, while ministries and local governments have spent too little time monitoring the activities of the enterprises under their supervision. Yet at the same time, the investment decisions of these firms have been heavily influenced by the political process.

Anthony Neoh, chief adviser to the CSRC and a former chairman of the Hong Kong Securities and Futures Commission, wrote in the *Far Eastern Economic Review* in May 1999: "(Chinese) Government officials...are not in the primary business of getting value from investments but in balancing the competing calls on their resources. The firms which report to them thus become hostage to these calls. Their managers feel obliged to follow "orders" to enter into investments which are perceived by their respective ministries or local governments as socially vital but not necessarily in the best interest of the enterprise as a business. So long as these managers are seen to play ball, they are left alone to do their own thing—hence the buying spree in recent years."

This "buying spree" involved the indiscriminate investment of huge sums of money (much of it raised in Hong Kong) in assets such as shares and property "without due regard being paid to the possibility of an economic downturn or to whether the firm could adequately manage the asset", said Mr Neoh. The Asian crisis knocked billions off the value of these assets and forced some state firms into bankruptcy, notably the Guangdong International Trust & Investment Corporation (GITIC), the investment arm of the Guangdong provincial government.

Yet it is significant that the central government allowed GITIC to fail. In the past it would have propped it up. Indeed, until recently, loss-making state firms typically went cap in hand to the government for handouts. But China can no longer afford to operate this way. State firms must become more competitive and self-reliant. Their managers need to become better educated, better paid and accountable to shareholders. Modern systems of governance have a role to play in this process.

For the foreseeable future, however, the main shareholder in state enterprises will remain the state. It is for this reason that the government must exercise its ownership rights and monitor companies. One way it is doing this is through the use of "inspector generals", whose job is to investigate fraud and corruption (the

The new Securities Law

This new law has eight main parts:

1. Regulation vested in one national organization.
2. Specified disclosure and other standards for all securities issued to the public.
3. Trading, clearing and settling only through approved institutions.
4. Companies and their officers must discharge duties of continuing disclosure.
5. Intermediaries must be licensed under specified standards.
6. Company officers and all professionals involved in disclosure have duties of due diligence.
7. Prohibition of insider trading and other market-manipulation activities.
8. Regulator has wide powers of investigation, but its decisions are subject to review by the courts and must be explained.

number of inspector generals is on the rise). Another is to improve financial regulation.

The government must also decide what to do with supervisory boards (China nominally follows the two-tier board system). These multi-stakeholder boards have not only been inactive, they lack a clear focus. The government needs to clarify whose interests these boards should represent, what role the Communist Party will play on them in future (Party secretaries still sit on supervisory boards), and who should exercise shareholder rights.

A further obstacle to corporate governance reform, over the short- to medium-term, is the absence of institutional shareholders in China. Institutional investors, of which there are only around 12 in the entire country, account for less than 1% of the stock market capitalization of US$325 billion. Over time this sector will need to develop if China's markets are to reach their full potential in terms of size and quality.

The future

In addition to the pressures building within China, external forces will also drive reform of the country's capital markets and, hence, the governance of its corporations. It is likely that the authorities will eventually remove the B-share restrictions and allow foreigners to invest in the main market (as they have already done for foreign insurance companies). The substantial amount of money that foreign banks have lost through bankrupt state enterprises like GITIC will lead (hopefully) to better risk management, higher standards and more accountability over time. And the ongoing listing of Chinese state enterprises on overseas bourses will enhance the demonstration effect for domestic firms.

Country overview

Hong Kong

"It has not been our practice to impose stringent standards of corporate governance on listed companies, which we believe is an issue of mind and attitude. We always adhere to the principle that governance of listed companies in Hong Kong should be set against an understanding of the reality of business practices in place, and it is our intention to provide companies with broad guidelines of corporate governance."

Alec Tsui, Chief Executive, The Stock Exchange of Hong Kong
In a speech to an audit committee seminar, December 17, 1998.

Introduction

Asian countries wanting to know where their corporate governance reforms might—or might not—be heading could do well to study Hong Kong. Since the publication of the Cadbury Report in 1992, the Hong Kong authorities have made quite a strong attempt to entrench governance principles in the corporate culture. Working groups have been formed to study how emerging global standards could best be adapted to local conditions. Professional associations have contributed considerable experience and knowledge to the debate. Regulatory officials have stressed, on many occasions, the importance of improving accountability, transparency and investor protection if Hong Kong is to maintain its position as an international financial center.

Progress has been made. Listed companies do have independent directors and they are now setting up audit committees. Yet beyond a core group of companies that are subject to international as well as local standards of governance—those listed on overseas markets, for example—it is apparent that most firms in Hong Kong still follow more the form of corporate governance than its spirit or substance. The most common explanation for this is that it is due to a business environment populated by family companies over which dominant shareholders have control. Yet it is also true that minority shareholders have traditionally been passive and that, until the Asian crisis, the practical benefits of corporate governance were not as compelling as they are today.

Catalysts for change

The main drivers of reform in Hong Kong have been the Stock Exchange of Hong Kong, the Securities and Futures Commission, professional bodies and a few maverick shareholder activists. Their initiatives in recent years include the following:

- **The Stock Exchange of Hong Kong** (www.sehk.com.hk) has, since 1992, amended its rules to require independent directors and encouraged greater disclosure, accountability and the use of audit committees. Each listed company must have a minimum of two independent non-executive directors on its board. A consultation paper on the expansion of financial disclosure requirements was published in late 1998. And since 1 January 1999 every listed company is expected to set up an audit committee. While this is not compulsory, the listing rules require that companies explain, in their interim and annual reports, whether or not they are complying.

The exchange has formed five working groups since 1993 to examine issues arising from the Cadbury Report and subsequent international studies. The fifth group, formed in 1999, is examining the role of non-executive directors, related-party transactions, family controlled companies and the Hampel Report, the latest successor to Cadbury.

In 1993, the exchange published a Code of Best Practice. This is a set of voluntary guidelines for boards of directors and is intended to embody, according to Alec Tsui, chief executive, "no more than what the exchange hopes the market *as a whole* will regard as best practice" (italics added). The Code suggests that companies hold full board meetings no less than every six months—a much weaker recommendation than similar codes in other parts of Asia. Like the policy on audit committees, listed companies must explain whether or not they are complying, with reasons for non-compliance. The Code has been revised since 1993.

Another general area of activity is director training. The exchange has organized seminars, training courses and conferences for directors in Hong Kong and China.

- **The Securities and Futures Commission** (www.hksfc.org.hk) is the market regulator, hence enjoys powers of investigation and enforcement that the exchange lacks (the highest penalty that the exchange can impose is suspension or de-listing). The commission has been taking a tougher stance in recent years over irregularities like insider dealing and embezzlement, and is increasing its monitoring of listed companies and directors. One of the reasons for this is the Asian crisis, which put "a number of people…under severe financial pressure", said Mark Dickens, head of enforcement, in 1998. The bigger reason is that it is constantly trying to raise standards of regulation in Hong Kong in line with international norms.

- **The Hong Kong Society of Accountants** (www.hksa.org.hk) has been the professional body with the highest profile in the corporate governance debate. It has issued five reports over the past few years on the application of international best practice to Hong Kong, the status of corporate governance in Hong Kong, how to form audit committees, and so on. It has a standing committee on corporate governance and runs training courses and seminars.

- **The Hong Kong Institute of Company Secretaries** (www.hkics.org.hk) has also been active. It runs training courses and seminars for its members, publishes a highly regarded journal, *Corporate Governance International,* and organizes a biannual international conference. It also covers corporate governance developments in Hong Kong and China in its monthly magazine, *Company Secretary.*

- **The Hong Kong Institute of Directors** (www.hkiod.com) has in the past been less active than its sister bodies, but this is starting to change. It recently launched a membership drive and has developed director-training programmes in both Cantonese and English. It is also compiling a list of capable and potential independent directors.

- **Shareholder activists** are a rare breed in Hong Kong. The doyen is Mark Mobius, president of Templeton Emerging Markets Fund (www.templeton.com.hk). He has been critical of Hong Kong companies for placing new issues privately, rather than offering them first to existing shareholders (his targets have been HSBC, Cheung Kong and Hongkong Electric). In their defense, the companies say the practice is both legal and common in Hong Kong.

New developments

Pressure for further reform comes from various sources. The Securities and Futures Commission will gain additional powers following the passage of the Composite Securities and Futures Bill, a draft piece of legislation designed to consolidate and update Hong Kong's fragmented securities laws, and which aims to strengthen the international competitiveness of Hong Kong's financial markets (the stock and futures exchanges have been demutualized and merged for the same reason). The bill not only imposes higher standards of transparency and accountability on the commission itself, it would give the organization more enforcement authority and allow it to respond more effectively to new technologies, particularly Internet trading. The gestation of the bill, however, has been long and tortuous. Its passage appeared imminent in late 1999, but it may now be delayed for several more months.

The Stock Exchange of Hong Kong spent much of 1999 preparing for the launch of "GEM", the Growth Enterprise Market (www.hkgem.com) or Hong Kong's second board. Because it is targeted at fast-growing small companies, GEM's entry barriers are less onerous than the main board: companies need only have a two-year, rather than three-year, history; and there is no profitability requirement. But its disclosure requirements are tougher: companies must report quarterly, for example. GEM signals a shift in Hong Kong's investor protection regime from a "merit-based system" (where the regulator judges the quality of listing candidates) to more of a US-style "disclosure-based system" (where investors make their own decisions based upon full, fair and timely disclosure of information).

In late 1999, the Hong Kong Society of Accountants published a new report on board compensation. Titled "Directors' Remuneration—Recommendations for Enhanced Transparency and Accountability", the report compared practice in Hong Kong with the US, UK, Australia and Singapore. It made several recommendations for enhanced disclosure and accountability, including the formation of remuneration committees "composed of wholly or mainly non-executive directors". The society initiated this study following press reports that certain loss-making companies had increased total board remuneration by between 160%-400% and after receiving complaints from minority shareholders.

Also towards the end of last year it was announced that the Standing Committee on Company Law Reform, a government-appointed body, would examine corporate governance as a matter of priority.

Obstacles

There are several entrenched obstacles to corporate governance reform over the short- to medium-term in Hong Kong:

- **Dominant shareholders**: Most Hong Kong listed companies are not widely held. This is mainly due to their family origins, but is also a byproduct of the listing rules: the minimum public float for listed companies is still only 25%. Given that controlling shareholders in most listed companies own equity stakes of between 35-60%, or higher, it is effectively impossible for any hostile minority shareholder action to succeed. Even a raising of the minimum public float—a policy that the Standing Committee on Company Law Reform is considering—would be unlikely to change this fundamental point.

- **Passive investors:** Most Hong Kong retail investors do not "vote their shares", they "vote with their feet" if they disagree with management policy. This is a rational choice given the high cost of taking action. Yet neither have institutional investors, domestic or international, been particularly active in driving corporate governance forwards.

- **Form over substance**: Listed companies do have independent directors, but it is questionable whether they are truly independent or, indeed, really understand what their roles should be. While there has been some director training in Hong Kong, few would argue that it has been either extensive or demanding. Directors do not need accreditation (something which the Hong Kong Institute of Directors is working to change) and most accepted board positions either because of the prestige attached or as an act of public service. Overwhelming anecdotal evidence and academic surveys conclude that most directors in Hong Kong do not challenge the CEOs or senior management of companies. "Rubber stamp" is the phrase most commonly applied to boards.

  Yet these problems are not entirely the fault of the directors themselves. Because companies generally do not like the added expenses and complications that board independence brings—at least initially—compensation for directors is low. There is not a culture in Hong Kong of questioning powerful CEOs, nor of seeking more information from a company than you are given as a member of its board. The net result is that Hong Kong has only a small cadre of people capable of becoming independent directors.

- **Levels of disclosure:** While reforms are planned, the levels of financial disclosure in Hong Kong are below international standards. Financial analysts complain that the information provided in interim and annual reports is insufficient to understand properly what companies are doing.

The future

Hong Kong's position as an international financial center will ensure that pressure for corporate governance reform continues. Securities legislation and regulation is being rationalized and, by all indications, the Securities and Futures Commission intends to get tougher on market malpractice. The Growth Enterprise Market will provide a valuable experiment in the extent to which high governance standards can effectively be applied to small companies. Audit committees will become more common, and remuneration committees are now on the agenda. Director training will expand. Hong Kong will move forward—but within the bounds of "the reality of business practices".

Country overview

India

"The concept of corporate governance has been attracting public attention for quite some time in India. The topic is no longer confined to the halls of academia and is increasingly finding acceptance for its relevance and underlying importance in the industry and capital markets. Progressive firms in India have voluntarily put in place systems of good corporate governance. … In an age where capital flows worldwide .. as quickly as information, a company that does not promote a culture of strong, independent oversight risks its very stability and future health."

The Kumar Mangalam Committee on Corporate Governance, October 1999

Introduction

The concept of corporate governance arrived fairly early in India. Since the launch of economic liberalization ten years ago, the nature of corporate management and accountability has been changing. The publication of the Cadbury Report in 1992 generated a great deal of interest in Indian corporate circles. In 1996, well before the Asian crisis erupted, the Ministry of Finance (www.finmin.nic.in) commissioned a committee to examine corporate governance. And in the same year, the Confederation of Indian Industry set up a national task force to develop a set of best-practice guidelines.

These domestic initiatives were partly a response to a series of corporate failures and financial scandals in the early 1990s, and partly motivated by the arrival of overseas investors and mutual funds around the same time. Interest in corporate governance has been fired again by the regional financial crisis. The finance minister, Yashwant Sinha, said in a budget speech in February 1999: "Lately there has been considerable debate on the importance of good governance of Indian corporates. It is increasingly being realized that if investors have to be drawn back to the capital market, companies have to put their houses in order by following internationally accepted practices of corporate governance. This is necessary to enhance investor confidence." Mr. Sinha then announced that he would institute a national award for excellence in corporate governance.

Although Indian corporate practice does not fit neatly into either of the two main governance models—the Anglo-American or German—the country, on balance, is tending towards the former.

Catalysts for change

Corporate governance has percolated to the surface of economic policymaking in India through a series of connected developments. In the late 1980s, the government addressed the interface between the stock markets and the corporate sector by revamping both the Securities Contracts Regulations Act and the Companies Act in 1988. One of the key issues dealt with at that time concerned the rules governing takeover activities. In the same year, the Securities and Exchange Board of India (www.sebi.gov.in) was set up as an administrative body.

This was followed in the early 1990s by the arrival of widespread deregulation, which created the environment for a booming stock market and permitted the return of multinational companies that in turn exerted competitive pressure on Indian companies.

In January 1992, the Securities and Exchange Board (SEBI) was given statutory status and powers to regulate and develop India's booming capital markets. Free pricing of initial public offerings, regulation of financial intermediaries and the evolution of the Takeover Code were developments dating from this time.

Towards the end of 1992, the stock markets were opened to foreign institutional investors. Registered foreign investors were permitted to invest in Indian stocks through portfolio investment funds (the first of which was set up by Jardine Fleming). Meanwhile, foreign direct investment required the approval of the central government.

The same year brought a serious financial scandal that had a drastic impact on the stock market. Many small investors lost their savings and, during the crisis of confidence that followed, retreated almost completely from the market.

While the securities scandal did not on its own spur the need for corporate governance in India, it highlighted the importance of greater transparency in capital market transactions. Subsequently, several corporations implemented voluntary codes of accountability, integrity and transparency.

In 1996, a three-member committee was constituted by the Ministry of Finance to examine the state of corporate governance in India. Their main findings were as follows:

- Companies had few clear models of governance to follow and levels of disclosure varied widely.
- Most directors were ineffective at monitoring management performance.
- The Indian corporate sector offered examples of both the best and worst kind of corporate governance.

Also in 1996, the Confederation of Indian Industry (CII) became the first business association to contribute to the debate by setting up a National Task Force on Corporate Governance. Two years later, the task force published a report titled "Desirable Corporate Governance – A Code", which made a series of recommendations on corporate governance reform in both private-sector and state-owned companies. Among other reasons, CII was motivated to take this initiative because of "public concerns regarding the protection of investor interests, especially the small investor". Its code closely resembles the Anglo-American "shareholder" model of corporate governance (though some of its recommendations deal with specifically Indian problems).

Another business association active in this area has been the Associated Chambers of Commerce and Industry of India (ASSOCHAM). Like CII, it focuses on corporate governance in general and tends to address large listed companies.

New developments

Awareness of the importance of corporate governance is growing among Indian companies as a result of these initiatives. Although it is not mandatory, the more progressive companies today devote a section of their annual report to corporate governance. The first to do so, in 1998, was Infosys Technologies (www.inf.com), a fast-growing developer of customized software and the first Indian company to list on NASDAQ. It was followed in 1999 by the Housing Development Finance Corporation (www.hdfcindia.com), Bajaj Auto (www.bajajauto.com), Nicholas Piramal (a diversified conglomerate) and others. The Tata Group (www.tata.com), one of India's pre-eminent conglomerates and oldest companies, has developed its own code of corporate governance.

Other recent developments include:

- **Revised CII code:** Following feedback from the corporate sector, and in response to ongoing changes in the international economy, CII formed a second task force in 1999 to improve its existing code. Called the National Committee on Corporate Governance, it is chaired by N. R. Narayan Murthy, chairman and CEO of Infosys Technologies. It organized a series of seminars across the country to educate the corporate sector about governance, and has been soliciting feedback from business and academia. A draft revised code was expected by November 1999, but has been delayed.
- **Stronger listing conditions proposed:** In 1999, SEBI set up the Committee on Corporate Governance to suggest changes to the listing conditions that would promote corporate governance and enhance long-term shareholder value. Under the chairmanship of Kumar Mangalam Birla, a well-regarded industrialist and member of SEBI's board, the committee released a draft report on 1 October 1999. The report's far-reaching recommendations include a tight deadline within which all listed companies should implement a corporate governance system, and state that 50% of board members should be made up of non-executive directors (with the number of independent directors dependent on whether the chairman is executive or non-executive: if executive, then independents should make up 50%; if non-executive, only 33%).

The committee also recommended, controversially, that development financial institutions and commercial banks—which are dominant in the financial sector and exert a strong influence over Indian corporations through their debt and equity holdings—should not seek board seats. Among the larger of these institutions are the State Bank of India, the Industrial Development Bank of India, and ICICI.

Other recommendations include the setting up of audit and remuneration committees, and the inclusion in annual reports of a separate section on corporate governance, including a detailed compliance report. To ensure that these recommendations are implemented, the committee argued that listing conditions should be considerably strengthened and the stock exchanges vested with greater powers.

- **Growing importance of corporate governance in the financial sector:** A number of factors are driving this trend, including: the increasing participation of the public in the ownership of public-sector banks; the entry of new private banks; and the need of all banks to access capital markets. Banks, as much as other companies, need to establish credible and widely accepted corporate governance arrangements, particularly if they want to attract global capital. In 1998, the Committee on Banking Sector Reforms, also known as the Narasimham Committee (II), addressed the issue of corporate governance in banks and the financial sector in detail. Meanwhile, the Unit Trust of India (www.unittrustofindia.com), the largest government-sponsored mutual fund in the country, recently held a seminar on corporate governance.

- **Rising interest among SMEs:** The Indian Merchants' Chamber (www.imcnet.org) is drafting a code on corporate governance to help family owned small- and medium-sized enterprises (SMEs) respond to global competition. The code will encourage enhancement of wealth to shareholders, promote a fair deal for customers, and help SMEs carry out their social responsibilities. The chamber also proposes to institute an annual award scheme for companies with good corporate governance.

The central bank's guiding role

Because bank performance carries systemic implications for the entire economy, the Reserve Bank of India (www.rbi.org.in) has a critical role to play in promoting corporate governance to the financial sector. This was highlighted in a speech in October 1997 by its then governor, Dr C. Rangarajan, and reaffirmed in monetary policies announced in April and October 1998. A discussion paper on corporate governance in financial institutions, published in early 1999 by Mr. S. H. Khan, former chairman of the Industrial Development Bank of India, clearly brought out the urgency and seriousness of the issues and offered a set of guidelines, including recommendations on the role of the Reserve Bank (RBI).

RBI has raised standards by, among other things, strengthening disclosure requirements and supervisory systems. In addition to central-bank supervisory systems (both off- and on-site), independent external auditors are playing a vital role in the governance and maintenance of the overall soundness of the banking sector. This follows a shift in recent years from state regulation to internal systems as the RBI encourages greater self-regulation. But it also puts more pressure on banks and financial intermediaries to improve standards.

One of the basic requirements of the RBI is that persons who control and manage the business of banks must have integrity, be highly skilled and experienced. To limit the control that any one group is able to have over any private-sector bank, RBI stipulates that no person can exercise voting rights in excess of 10%. The central bank has also directed banks to set up audit committees and emphasized the primacy of the board of directors.

Recently, RBI introduced a corporate governance rating system for banks as part of the CAMEL analysis process (ie, capital adequacy, asset quality, management, earnings, liquidity and system). This takes into account the working and the effectiveness of the board and its committees, including the audit committee; the effectiveness of management in ensuring regulatory compliance; and the adequacy of control exercised by head office in addition to ensuring asset quality and profitability.

Obstacles

Various factors are likely to slow the adoption of sound corporate governance in India. One simple factor is that until recently very few companies knew very much about it. Beginning in 1998, there has been an explosion of interest in the subject among the country's more progressive companies, such as those mentioned earlier (under "New developments"). But the vast majority of listed and non-listed firms are family owned or closely held, and have traditionally engaged in insider practices such as related-party transactions and cross-shareholdings. It will take time for such companies to see the value of becoming transparent.

A second issue is that the implementation of corporate governance remains largely a matter of self-regulation, and a broad consensus on what it means has yet to emerge. Corporations, banks and non-bank financial companies, and the capital markets all approach the subject from different angles. There are several regulators (RBI for banks and non-bank financial companies, SEBI for capital markets, the National Housing Bank for housing finance companies) and various promoters (CII and other industry associations for large companies), but no apex organisation capable yet of leading the process and setting standards. Hence, progress is likely to vary from sector to sector. The recommendations of the Kumar Mangalam Committee may mark a turning point and become a de facto standard for the wider economy, although they have yet to be officially accepted by the SEBI board.

A third problem is the legacy of state ownership of financial institutions. State banks say it is easier for private-sector banks to comply with higher standards of transparency and accountability, since they are not carrying the burden of "policy loans" from the past (ie, loans made for political rather than commercial reasons). If state banks have to disclose the real state of their balance sheets, this would reflect badly on them. The current managers of these banks say this situation is not their fault—they inherited it. Hence, resistance from these banks to higher standards of disclosure is likely.

Government ownership

Government ownership complicates the corporate environment in India in various ways. Although it has been moving in the right direction by divesting itself of assets in recent years, the state retains majority control of many financial institutions. This slows down the pace of reform, ensures that such companies are still subject to the political process (through the nomination to their boards of political appointees, who change frequently), and sets up a conflict between the expectations of the various shareholding groups (the state, private institutional investors, and members of the public). While the state sees capital raising as paramount (to achieve political objectives), non-government shareholders want value creation. This suggests that privatization should be extensive, not partial, and that minority shareholders should have the right to approve political appointees to boards.

Another problem is the conflict of interest that arises when state institutions are both owner and regulator of other state-owned companies. RBI has this dual role over the State Bank of India and the Industrial Development Bank of India, while the National Housing Bank has the same in regard to various housing finance companies. The solution is to corporatize these entities (if they have not been so already) in order to give them managerial autonomy and allow them to start operating as companies (rather than quasi-government departments). The next step would be to privatize them fully, or as much as possible.

The future

Interestingly, what may drive this process forward is a "demonstration effect" from the private sector: the better performing private companies will move so much further ahead in terms of profitability, efficiency and ability to raise capital that they will start to put pressure on the government. Over the past year, for example, Infosys has doubled its revenue and profit after tax, while its share price has multiplied four times since listing on NASDAQ in March 1999. It would be hard for the government not to take note of such an impressive performance.

References

A copy of the draft Kumar Mangalam report can be downloaded from:

www.sebi.gov.in/report/corpgovern.html

Country overview

Indonesia

"The findings suggest that the concentration of corporate control in the hands of a few families is a major determinant in the evolution of an inefficient legal and judicial system, and corruption."

Dr. Suad Husnan, Gadsah Mada University, Indonesia
Referring to a World Bank paper, "Who Controls East Asian Corporations?" (February 1999).

Introduction

While all Asian countries face a steep climb in their efforts to promote real improvements in disclosure and accountability, Indonesia has some of the highest and trickiest mountains to cross. The country contains all the problems present in other parts of the region—dominant shareholders, ineffective regulatory and financial institutions, weak investor and creditor protection, and so on—only in more exaggerated form.

Although the government has promoted corporate debt restructuring as part of its overall economic reform package, it has barely focussed on issues of corporate governance (outside of banking). Understandably, given the devastation wrought by the Asian crisis, its immediate priority has been to strengthen Indonesia's broader institutional and economic framework, particularly in the area of bankruptcy and financial system reform. Yet this is only one part of the explanation: the other is the concentrated ownership structure of the corporate sector, which acts an immense inhibitor to corporate governance reform.

Catalysts for change

Prior to the Asian crisis, interestingly, Indonesia made some moves on paper towards greater corporate openness. In 1995, the government introduced a new Corporation Law. Influenced partly by the Dutch corporate governance model, it stipulates that limited companies must have both a "board of commissioners" and a "management board" (the former supervises the latter, provides strategic guidance and in some cases approves management decisions; the latter runs the company). The two boards should serve the best interests of the company, not merely the dominant shareholders. The highest institution in the company is the general shareholders' meeting, which appoints the two boards. And shareholders have a wide range of modern rights and safeguards: access to information; proxy voting; one share, one vote; the right to call emergency meetings and make proposals; and a guarantee that connected interests and inter-company affiliations will be disclosed, an independent auditor will be appointed, and that an independent board committee will be set up.

In the same year, the government enacted the Capital Market Law, the legal instrument regulating listed securities and market players. Apart from delineating the responsibilities of the various regulatory authorities, it lays down rules covering financial disclosure and auditing, transparency, insider trading, and so on. Supplementary regulations state that where a management decision could create a conflict of interest for the dominant shareholder, the decision should be approved by the independent shareholders (ie, controlling shareholders have no vote).

Because the Asian crisis exposed serious weaknesses in the strength and regulation of the Indonesian financial system, much of the government's effort over the past two years has been directed at bank recapitalization, closure and restructuring. In 1997 the government established the Indonesian Bank Restructuring Agency (IBRA) to supervise, and in some cases manage, the "problem" banks under its wing. In October the following year it amended the Banking Law of 1992 to require that banks lend only when collateral can be offered (prior to the crisis, large conglomerates had set up their owns banks and lent indiscriminately to themselves and their friends).

Another major problem area has been protection for creditors—under the old Dutch system that Indonesia followed there basically wasn't any, and creditors could not force debtors into bankruptcy. Hence, a new Bankruptcy Law was passed in August 1998 and a new Commercial Court created. The law aims to make bankruptcy proceedings more efficient, introduce a higher degree of certainty into the process (for creditors) and to encourage debt restructuring. It also marks the beginning of a new profession in Indonesia—that of the private receiver. Previously, only public trusts could perform this role; today private accounting firms and others are permitted to do so too. The government's goal has been to prod debtors into sitting down at the negotiating table with their creditors. Initially, it worked quite well until the courts brought down some bad decisions against creditors. Now debtors are ignoring the process and challenging creditors to take them to court.

Four main official and quasi-official organizations have some level of enforcement power or responsibility for corporate governance. They are:

- The Capital Market Supervisory Agency or "Bapepam" (www.bapepam.go.id).
- The Jakarta Stock Exchange (www.jsx.co.id).
- IBRA (the Indonesian Bank Restructuring Agency).
- The Ministry of State-Owned Companies.

The level of interest shown by these agencies varies. Bapepam is the coordinating authority for corporate governance, but has produced little so far in the way of new regulations or policies. The Jakarta Stock Exchange has proposed some changes to its listing conditions, but requires the approval of Bapepam before it can go ahead (see "New developments" below). IBRA is supposed to be promoting transparency and accountability to the banks and private companies it is helping to restructure, but nothing significant has come from this yet. Meanwhile, the Ministry of State-Owned Companies is running a governance pilot programme for certain state enterprises under its wing (see also "New developments below).

There is also a handful of professional bodies and non-governmental organisations quite active in this area. Two of the most prominent are the Internal Auditors Association and the Indonesian Society for Transparency (www.transparansi.or.id).

In 1995, the Internal Auditors Association worked with Bank Indonesia, the central bank, to formulate an internal audit standard for banks (which became a directive in March of that year). This stipulated that every bank must have an internal audit unit and an independent audit committee. But in September 1999, this rule was repealed by a new law giving independent status to Bank Indonesia. In place of audit committees, each bank must instead have a compliance director who should behave as independently as possible. Not surprisingly, the Internal Auditors Association is understood to be less than happy with this change.

The Indonesian Society for Transparency, an independent organization, was formed in August 1998 to promote good governance in both the public and corporate sectors. Its aim is to "spearhead the creation of a National Integrity System by encouraging clean and healthy practices in business, government and the community". It organizes seminars, conducts research and publishes a regular newsletter. Its chairman is Mar'ie Muhammad, former finance minister, and its board boasts several prominent businessmen and former ministers. Its Secretary General is Erry Riyana Hardjapamekas, CEO of PT Timah (www.pttimah.com), a large state-owned mining company.

New developments

Recent initiatives involving the organizations listed above include the following:

- In a move designed to reduce ownership concentration in Indonesian corporations, **Bapepam** now allows listed companies to offer additional equity directly to the public (ie, not just to existing shareholders).
- The **Jakarta Stock Exchange** has proposed amendments to its listing rules that would require all listed companies to appoint independent commissioners and an audit committee. Moreover, in January 1998 the government tightened disclosure rules by stating that all listed companies must have a corporate secretary responsible for this function.
- The **Ministry of State-Owned Companies**' pilot scheme to enhance governance involves five state

firms: PT Timah; PT Pelabuhan Indonesia III, a port operator; PT Bank Mandiri: PT Sang Hyang Seri, an agro-producer; and PT Taspen, a pension and insurance fund.

PT Timah, in its 1998 annual report, described a reorganization of the company's structure and operations at the time in the following terms: "Contrary to some suspicions that the reorganization was contemplated to bury bad numbers, the decision was indeed fortified with our intention to improve corporate governance. The new structure brings with it increased accountability and transparency."

• The **Indonesian Society for Transparency** is in the process of establishing a new body called the Institute of Corporate Governance. Its first activity will be an international conference in April 2000.

Obstacles

The obstacles to corporate governance reform are well entrenched. In a recent paper for the Asian Development Bank (ADB), Dr Suad Husnan of Gadsah Mada University describes with clarity the historical patterns of corporate ownership in Indonesia. Drawing partly on the 1999 World Bank paper mentioned at the beginning of this chapter, he outlines the following structure and issues:

• **Family domination:** In 1996, more than two-thirds of listed companies were controlled by families.

• **Ownership concentration:** In 1997, the largest shareholder in each listed company (the founder) owned slightly less than 50% of the shares. The second biggest shareholder owned around 12. The public owned almost 30%. While these figures have moved somewhat in favor of the public since 1993, the change is not large (see Chart 1).

Keeping control Chart 1

Ownership concentration in Indonesian public companies

	Biggest	Second biggest	Third biggest	Fourth biggest	Fifth biggest	The public
1993	50.5%	16.6%	3.0%	2.1%	0.5%	26.9%
1997	48.2%	11.6%	4.4%	2.1%	1.2%	29.7%

Source: The Indonesian Capital Market Directory, quoted in *Suad Husnan, 1999*

Wider implications Chart 2

Correlation between ownership concentration and the weak Indonesian legal system

Market cap of top 15 families	61.70%
Efficiency of judiciary	2.50%
Rule of Law	3.98%
Corruption	2.15%

Note: Numbers based on a 1-to-10 scale, with 10 being the best.

Source: Stijn Claessens, Simeon Djankov and Larry H.P. Lang "Who Controls East Asian Corporations?" Financial Economics Unit, Financial Sector Practice Department, World Bank (February 1999); quoted in *Suad Husnan, 1999*

• **Family giants:** Companies controlled by one family, the Suhartos, account for almost 17% of the total market capitalization of the Jakarta Stock Exchange; while those controlled by the top 15 families amount to more than 60% of the market cap.

• **First-generation alive and well:** In 1996, 43% of the largest 300 conglomerates in Indonesia were managed by their founders, while another 39% were jointly managed by the first and second generations.

• **Legal system undermined:** Indonesia's narrow corporate ownership structure, and its historically close links with government, appears to have impeded the development of an efficient judiciary, a fair and transparent legal system, an ethical business environment, and a form of governance that respects minority shareholders (see Chart 2).

This structure explains why the impact of such reforms as the Corporation Law have so far had only limited impact. First, although the board of commissioners is supposed not to represent the major shareholder, it typically does: its chairman is usually a family member or a trusted friend. Second, other family members act either as company managers or sit as commissioners. Third, according to an ADB survey of 40 listed companies, only 25% of them have appointed "independent" commissioners.

The future

Because Indonesia is just at the beginning of its corporate governance reform process, and given the stiff resistance from local companies, the pace of change will clearly be slow. Nevertheless, the concept of "independence" has entered the vocabulary of the regulatory authorities and some corporations are starting to take it seriously. With the old political and legal system now in disrepute, it may well be that future commercial success will depend more on an understanding of the market and less on political connections. In this environment, the need to treat shareholders fairly could well assume greater importance.

References

This chapter benefited from two papers in particular:

• Dr Suad Husnan, "Indonesian Corporate Governance: Its Impact on Corporate Performance and Finance", November 1999 (produced as part of a regional study for the Asian Development Bank).

• David Webb, et al, "A Consolidated Report on Corporate Governance and Financing in East Asia", November 1999 (produced for the same ADB study).

Country overview

Japan

In reality … in Japan the respective roles of directors and managers have not necessarily been clearly defined. Furthermore, the distinction between the governance role of the board of directors on the one hand, and the management role of managers on the other, is complicated by the existence of a separate board of auditors, whose role is to audit the activities of management. This body has meant that in practice the Japanese board of directors has not necessarily been equipped with sufficient governance authority or capability, while the board of auditors has been little more than a cosmetic shell."

Corporate Governance Forum of Japan
From the Introduction to "Corporate Governance Principles—A Japanese View", May 1998.

Introduction

It was in the early to mid-1990s that the term corporate governance began to be popularized among managers and academics in Japan. The term first appeared in a major Japanese newspaper in 1992. The following year, William Crist, president of the Californian Public Employees Retirement System (CalPERS), the leading activist public pension fund in the US, made a strong impression when he spoke to Japanese executives in Tokyo. In 1994, the Corporate Governance Forum of Japan was established.

The deep recession that Japan has suffered during the 1990s is sometimes called "Corporate Governance Fukyo" in Japanese. This means that the main cause of the recession was the lack, or incompleteness, of corporate governance systems. It is now widely understood that a monitoring system which seeks to ensure that management maximizes shareholder value can lead to an improvement in the performance and competitiveness of Japanese companies. An indication of this new thinking is the way in which some institutional shareholders are starting to vote their shares.

Catalysts for change

There are several catalysts for corporate governance reform in Japan. The Corporate Governance Forum of Japan is an influential non-governmental organization that aims to study these issues through collaboration between industry and academia. It published a set of Corporate Governance Principles, quoted above, in 1998. These principles, which are the first example of their kind in Japan, provide a detailed and frank discussion of traditional governance systems and recommendations for improvement.

The Tokyo Stock Exchange (www.tse.or.jp) is working on its own corporate governance principles and, in 2001, will host the annual meeting of the International Corporate Governance Network, which was formed in the mid-1990s to represent institutional investors.

Japanese industry associations, such as Keidanren (Japan Federation of Economic Organizations) and Keizai Doyukai (Japan Association of Corporate Executives), add a management perspective to the debate. If you visit the website of Keidanren (www.keidanren.or.jp), you will see that it has a committee on corporate governance and has been urging the government to push forward with reforms (within the context of general regulatory and economic

Finance rules
Division of share ownership in Japan, 1998

Number of listed companies	2,426
1. Governments (central & local)	0.5%
2. Financial institutions	39.3%
3. Business corporations	24.1%
4. Securities corporations	0.7%
5. Individuals	25.4%
6. Foreigners (companies/individuals)	10.0%

Note: The category "financial institutions" mainly includes banks, trust companies, and insurance companies.

Source: Shoken No. 605 (August 1999).

reform). Keizai Doyukai's website (www.doyukai.or.jp) contains, among other things, a speech that its chairman gave in 1999 on the subject of governance.

Some Japanese institutional investors, especially life insurance companies and investment advisors for pension funds, have actively begun voting at the annual general meetings of their portfolio companies. This is an epoch-making event. Traditionally, corporate management has been supported by stable cross-shareholdings among affiliated companies within large business groups (keiretsu), while the annual meeting is merely ceremonial with no one interested in voting. The fact that many corporations used to hold annual meetings on the same day made it impossible for small shareholders to attend.

The other key drivers of reform are companies themselves. The management of some international companies, such as Sony (www.world.sony.com), are trying to incorporate aspects of the Anglo-American model into their management practices. Sony for example reduced the size of its unwieldy board from 40 members to just 10 in 1997 (about 300 companies followed suit) and held its first open conference with shareholders (after its annual meeting) in June 1999.

Big boards developed in Japan because most directors have been employees of the company. Before smaller boards became popular, the average board size was around 30 people; although some had as many as 50-60 directors.

Obstacles

The practice of cross-shareholding is a major impediment to corporate governance reform. The stable shareholders say little to management and do not perform a monitoring function. However, because this system has led to an inefficient use of shareholder capital, the equity interest of stable shareholders is being gradually reduced (to less than 50%).

A second obstacle is the lack of independent directors. An increasing number of people, however, now support the concept of board independence. The Corporate Governance Forum of Japan states in its Principles that: "The board of directors should include independent, non-executive directors who have no direct interests in the company. A system of support to provide necessary information to these directors should be established and enhanced."

The Principles also say that the functions of the board of directors and "any management board" should be separated "so that corporate decision-making and business execution are clearly distinguished". Moreover, independent directors should comprise more than half the seats on the board of directors. And sub-committees should be established to deal with the appointment of directors, remuneration of executive and non-executive directors, and corporate governance.

The Corporate Governance Forum explains that it is making these suggestions in order to "rejuvenate and strengthen" the Japanese board system. "It is questionable whether the Japanese board of directors actually complies with the Commercial Code's stipulation that it functions as the body which decides on corporate will and exercises corporate oversight." This is because it is usually too large to have any "meaningful discussion on overall company policy and strategy". Decision-making is therefore vested in smaller groups like the board of managing directors.

There is also a move to strengthen the independence of statutory auditors, who have the responsibility of monitoring the legality of business conducted as well as the accuracy of financial statements. A special law applying to the largest companies provides that each company must have at least one independent statutory auditor. Typically, a CPA firm checks company statements and then a statutory auditor checks them again. However, as the quote at the beginning of this article highlights, the duties and powers of these auditors need to be developed if they are to play their role fully.

The future

Increasingly, the evaluation of international investors will outweigh government regulations in importance. It is for this reason that the Corporate Governance Forum developed its principles and major Japanese multinationals are changing from within. Although the pace of reform has been slow, the signs are that it will steadily continue.

Country overview

Korea

"Reforms must continue with unwavering determination and drive. Continued emphasis will be placed upon corporate reforms. Without restructuring the corporate giants, the chaebol, the most problematic element in our economy they represent, economic reforms cannot be completed. The times have changed. The concentration of economic power in the chaebol is no longer accepted by the market. What matters now is not quantity but quality."

President Kim Dae-jung
From a speech on chaebol reform on Independence Day, August 15, 1999.

Introduction

In spite of stiff opposition from the country's huge conglomerates (chaebol), corporate governance reform is gradually being implemented in Korea. The chaebol believe that they have more to lose than gain from governance reform, in part because they think that it will undermine their dominance of the Korean economy (see charts 1 & 2). Hence, they are trying to water down government and community efforts to make them more transparent and accountable.

At the same time, awareness of corporate governance among general shareholders remains low. While almost everyone agrees on the need for such reform, Korea lacks, by Western standards, the consensus-building and organizational ability to promote active discussion on the subject. Recent history shows that most political, social and economic reform movements—other than those which directly affect the everyday life of Koreans, like the democracy movement—have had little real impact on public policy-making. This may be one of the reasons why much of the public has reacted passively to the recent emergence of corporate governance as a "hot topic" in the media.

Still in control Chart 1
Top 5 chaebol: ownership of assets in major sectors

Non-bank finance	34.7%
Fire & marine insurance	47.3%
Securities	54.6%
Credit cards	52.2%
Life insurance	40.3%
Investment trusts	30.2%

Source: Fair Trade Commission, quoted in *The Korea Herald, July 21, 1999*

Increasing control Chart 2
Top 5 chaebol

	March '98	March '99
Equity interest in affiliated companies	46.6%	53.5%
Deposits in financial institutions:		
– as % share of non-bank financial sector	17.0%	34.0%
– as % of total deposits in the financial system, incl banking	4.8%	13.4%

Source: Fair Trade Commission, quoted in *The Korea Herald, July 21, 1999*

Nevertheless, progress is being made through the enactment of new legislation and guidelines, and through shareholder activism. These counter-balancing trends will continue as Korea further opens its product and capital markets to foreign investment and global competition.

Catalysts for change

The first group to approach the subject of corporate governance was the academic community. The practical benefits of its work, however, were limited as much by the abstract nature of the discussion as by its inability to influence Korean corporations in a systematic manner (because of legal constraints).

The entrance of foreign investors into the Korean capital markets after 1992 had the effect of bringing in developed-country notions of investor relations. This sparked some discussion of the need for management reform as a way to attract foreign capital, although few practical measures were taken until after the Asian financial crisis. As with much of Asia, it was the crisis that instigated a national debate about the way in which local corporations were governed and managed.

The most widely held view is that Korea's chaebol contributed directly to the crisis through an excessive build-up of debt—average debt-to-equity ratios previously ranged from 400-500%—and massive over-investment. In early 1998, the new government of Kim Dae-jung responded by instructing the chaebol to follow "five principles":

- Significantly reduce debt;
- Restructure through both sale and merger, with the aim of becoming more efficient and smaller overall;
- Eliminate "mutual payment guarantees" among affiliates (a practice that had led to the huge levels of debt);
- Improve management transparency (by, for example, producing consolidated financial statements for their entire group); and
- Strengthen the rights of minority shareholders.

Regulatory reform

The government has enacted new legislation to give effect to some of its five principles. For example, the amended Law on External Audit of Joint Stock Companies now requires that the top 30 conglomerates prepare consolidated financial statements and set up audit committees in all their listed companies and affiliates from 1999.

Other changes in law have included the lifting of a ban on foreigners acquiring Korean firms, and the prohibition of all new mutual payment guarantees among companies belonging to the top 30 chaebol after 1998 (all outstanding guarantees prior to that time must be retired completely by March 2000).

The Korea Stock Exchange has also been revising its rules. Since February 1998, all listed companies must allocate 25% of their board seats to outside (ie, independent) directors. They must also make timely disclosures of major corporate decisions, such as equity investments that amount to more than 10% of a company's stock.

The other prong of the government's policy is to strengthen the rights of institutional shareholders so that they may act as "management supervisors". It has given them the right to vote on important decisions relating to mergers and acquisitions, business transfers, and the election of directors, among other things. It has also relaxed requirements restricting shareholder action: whereas prior to March 1998 a shareholder needed to own a minimum of 1% of the total equity of a company before it could file a derivative suit, today this hurdle has been lowered to just 0.01%.

Another significant catalyst for reform has been the non-governmental sector. Citizen activist organizations like The Citizens' Coalition for Economic Justice, and People's Solidarity for Participatory Democracy (www.pspd.org) have been aggressive in trying to force more accountability. People's Solidarity, in particular, has received considerable domestic and international attention following its campaigns against Korea First Bank (for making bad loans to Hanbo Steel Company), SK Telecom (for inappropriate financial transactions within the SK Group) and Samsung Electronics (for improperly issuing private convertible bonds).

Foreign institutional investors have also been driving certain changes. Since foreign funds now account for around 20% of total market capitalization, many participate actively in the management of their invested companies. The most high profile has been Tiger Fund, an American fund that until recently held almost 10% of SK Telecom's shares. Following a dispute with the company over a new rights issue in August 1999—which it objected to—Tiger recently pressured the company to buy back its equity interest.

New developments

While many of these efforts have led to significant changes in chaebol behavior, the government has found the pace of reform too slow. To accelerate it, President Kim said in his August 1999 speech (quoted above) that the government would put significant emphasis on a new code of best practice being drafted at the time by the Committee on Corporate Governance.

The Committee was set up in March 1999 by the Ministry of Finance and Economy (www.mofe.go.kr) and comprised members from business, finance, accounting, law and academia. It produced its final recommendations in September 1999, following which the Ministry of Finance and Economy reflected the recommendations in revisions to the Security Transaction Act and five other laws.

The broad outlines of the bills, which are aimed primarily at publicly listed companies, are familiar: independent directors, audit and nomination committees, enhanced shareholder voting and participation rights, greater disclosure of major decisions by the board, protection of stakeholders like creditors and employees, and so on.

According to the revision bills, listed companies with assets of W2 trillion (US$1.6 billion) or more will be required to fill 50% of their board membership with outside directors from 2001.

From 2000, it will also become mandatory for these firms to have three or more outside directors on their boards, to set up an in-house panel tasked with recommending outside directors, and an audit committee.

Securities firms and insurance companies with assets of W2 trillion or more, however, will be obliged to fill 50% of their board with outside directors from 2000. The same rule will apply to investment trust companies (ITCs) that have customer deposits of similar value. The rule is stricter for these firms because the government has decided that they are the foundation for building a more open and transparent economy.

In all, a total of 92 non-financial firms—or 13.5% of those listed on the Korea Stock Exchange—will be subject to these new requirements. They will affect eight securities brokerage houses and 19 ITCs and investment trust management firms. (For further details on the code of best practice, see the accompanying box on the next page).

Another new development has been the release, in December 1999, of a draft report on "Corporate Governance in Korea at the Millennium". Produced by a consortium of international and domestic lawyers for the Ministry of Justice, the report makes a wide range of detailed legal recommendations for enhancing and enforcing shareholder rights, monitoring related-party transactions, empowering boards of directors, improving disclosure, and so on. Workshops have been held to discuss the report, and the intention is to have the final draft ready by early 2000.

Obstacles

The foremost obstacle to corporate governance reform is, not surprisingly, the chaebol. Chaebol lobby groups, notably the Federation of Korean Industries, have criticized the compulsory nature of the bills as being outdated, contrary to the spirit of capitalism, and out of sync with the rest of Asia. They also believe that too many outside directors may infringe upon their managerial rights.

The chaebol have lobbied hard against certain aspects of the recommendations. The most contentious rule was one stating that large listed firms with assets of more than W1 trillion (US$835 million) must allocate 50% of their board seats to outside directors from 2001. This was later revised to apply only to "super-large" enterprises with assets worth more than W2 trillion after the government accepted the chaebol's argument that the original proposal would create a host of adverse effects, such as delayed investments and decision-making.

The government has also decided against introducing a "collective voting and litigation system" that would have allowed minority shareholders to elect one board member and punish senior management for failure.

Two other obstacles to corporate governance reform are worth mentioning. One is the banking industry: having spent years providing funds to the chaebol under the direction of government, its ability to act as a watchdog over corporation management is severely constrained. Another concerns the relationship between domestic institutional funds and the chaebol: the reality is that these investors will find it difficult to play an active and independent role because many are subsidiaries of the very conglomerates they are supposed to monitor.

The future

Chaebol resistance to both the spirit and the letter of corporate government reform suggests a difficult road lies ahead. Yet it is important to recognize that many market participants believe that reform is at least going in the right direction. While the government cannot change management behavior overnight, it has promulgated some significant new policies and legal amendments over the past 18 months. Foreign institutional investors will increase their purchase of direct equity stakes in Korean companies and gradually introduce new ideas. And it is reasonable to assume that some Korean companies may willingly change from within as they expand their businesses overseas, forge partnerships with foreign strategic or financial investors, and seek funding from the international capital market. Korea, having officially decided to adopt elements of global corporate governance standards, will undoubtedly try to adapt them to its own needs in coming years. The role of its capital and stock markets will be of paramount importance in determining how successful Korea becomes in this endeavor.

The "Code of Best Practice for Corporate Governance", September 1999

The main elements of the code devised by the Committee on Corporate Governance are as follows:

Board of directors

- Financial institutions and large publicly listed corporations with assets of W2 trillion or more should gradually increase the number of outside independent directors to more than 50% of the board (they must have a minimum of three outside directors).
- Other listed companies should allocate at least 25% of the seats on their boards to outside directors, while banks and public-sector corporations should allocate 50%.
- A nomination committee system should be introduced (with outside directors making up more than 50% of the members).
- Outside directors should have no financial interest in the company or relationship with the management or controlling shareholder.
- The board should meet no less than once a quarter.
- The performance of management, the board and the outside directors should be evaluated, and this report made public.
- Compensation for management should be commensurate with performance, and a compensation committee comprising mainly outside directors is recommended.

Management

- All information that may have an impact on the decisions of shareholders or stakeholders should be disclosed.
- Companies in which foreign investors hold more than 20% of the equity should disclose information in both Korean and English.
- Governance structures should be disclosed in annual reports and evaluated by shareholders and stakeholders. Companies should explain the extent to which their structures comply with this code, and how they intend to improve.
- The equity ownership of controlling shareholders and "specially related persons" should be disclosed in detail.

Auditing

- Large public corporations, state companies and financial institutions should have an audit committee.
- At least two-thirds of the committee should comprise outside directors.
- The chairman should be an outside director and at least one member should have specialist auditing experience.
- External auditors should be independent from the company.

Shareholders

- Shareholder meetings should be scheduled and located so that all shareholders can attend without difficulty.
- Since many small shareholders own stock in several different corporations, meetings should be arranged on different dates.
- The shareholder proposal system should be improved. The existing Commercial Law should ease its restriction on proposal periods and re-proposals.
- Many different kinds of voting methods, including electronic and postal, should be introduced.
- Restrictions on the right of shareholders to inspect accounting books should be eased.
- Shareholders should exercise their right to vote. Large shareholders that can exert influence over management should speak for the interest of the company and all shareholders.

Stakeholders

- Companies should abide by procedures for protecting creditors.
- Companies should improve and maintain working conditions, and comply with labor laws. They should also fulfill their social responsibilities in areas such as consumer protection and environmental conservation.
- The form and level of employee participation in corporate governance should be determined in order that corporations achieve sound development.

Country overview

Malaysia

"The economic turmoil had, within less than a year, taught corporate Malaysia that corporate governance or rather the lack thereof, can exact a heavy toll from the markets."

High Level Finance Committee on Corporate Governance
From the introduction to its "Report on Corporate Governance", February 1999

Introduction

Malaysia began incorporating modern governance principles into its securities and companies legislation relatively early. But as in the rest of Asia, the financial crisis caused a resurgence of interest in the subject among government and business circles. In March 1998, the authorities established a committee—the High Level Finance Committee on Corporate Governance—to review the situation and make recommendations for raising governance standards and strengthening investor confidence in local capital markets. The committee's recommendations were finalized in February 1999 and remain under review by the authorities. Some have been implemented.

Catalysts for change

The government has been the main catalyst for corporate governance reform in Malaysia. The High Level Finance Committee on Corporate Governance, which comprised members from both government and business, made an extensive study of the corporate environment in Malaysia and produced a detailed report containing three main sets of recommendations:

First, a "Proposed Malaysian Code on Corporate Governance" aimed primarily at boards of listed companies.

Second, a long list of recommendations on the changes in laws, rules and regulations needed to strengthen the regulatory framework for publicly listed companies. One of the key issues addressed was clarification of the responsibilities and obligations of major shareholders (especially in grey areas such as related-party transactions). The committee concluded that there was also a need to improve the accuracy and timeliness of disclosure, to increase the value of general meetings, and to raise the efficiency of shareholder-redress mechanisms.

Third, recommendations for the training and education of directors, potential directors and officers of listed companies and other market participants.

More recently, the government has amended various laws to improve standards of governance.

In line with the recommendations of the High Level Finance Committee, the Securities Commission (www.sc.com.my) and the Stock Exchange (www.klse.com.my) introduced expanded disclosure requirements during 1998-99. For example:

- Listed companies are now required to announce their results on a quarterly basis;
- Legislation on insider trading and dealings by directors and substantial shareholders has become more stringent; and
- The period for voluntary suspension of share trading has been limited.

In early 1999, the government also undertook a comprehensive revamp of the Code on Takeovers and Mergers.

It is important to note that these legislative changes come several years after Malaysia first introduced corporate governance principles into its securities and companies legislation. For many years, publicly listed companies—of which there are almost 750—have been required to appoint independent directors. While no minimum number was mandated, in practice most companies have at least two.

Since 1994 listed companies have also been required to form audit committees comprising at least three members, a majority of whom must be independent non-executive directors. Around the same time, the government also stipulated that companies include the terms of reference of their audit committee in annual reports.

A number of other organizations are involved in corporate governance reform in Malaysia, including chambers of commerce, professional bodies and new organizations such as the Malaysian Institute of Corporate Governance. The institute was established in early 1998 by five industry and professional bodies covering publicly listed companies, board directors, accountants, auditors and company secretaries. It is contributing mainly to training and education.

Although shareholder activism has been marginal in Malaysia—a factor probably due to the country's large retail investor profile and dominant-shareholder corporate structure—this is starting to change. While institutional investors have traditionally not monitored listed companies, the government is encouraging the bigger funds to take the lead. Coordinating this initiative is the Employees Provident Fund, a large statutory pension fund governed by a mixed board of government, employer, employee and professional representatives (who are appointed by the minister of finance). The fund has encouraged other major institutional investors to join a "minority shareholders watchgroup" and to push for enhanced shareholder value from Malaysian corporations. The plan is to form a non-profit company that will supply institutional funds with research and guidance.

Obstacles

Since the government is the primary instigator of corporate governance reform in Malaysia, it is likely that a substantial amount of the reform program will be implemented. Unlike many other parts of the region, Malaysia does not have weak regulatory institutions and inconsistent regulations. On the contrary, the powers of the Securities Commission are extensive and the rules clear.

Nevertheless, as dominant shareholders are common across corporate Malaysia, it would be surprising if the country did not suffer from many of the problems common elsewhere in governance reform, namely opaque management, parochial mindsets, unethical practices, as well as timid or disinterested minority shareholders and independent directors who are less than independent.

Government ownership

State ownership in Malaysia is restricted to a small number of corporations involved in providing essential services, such as power generation and distribution, airlines and telecommunications. Although corporate governance is relevant to the state sector, given the limited number of state companies that are publicly traded, it is unlikely that government ownership will have a significant impact on the development of corporate governance in the private sector.

The future

Malaysia has already adopted the main outlines of the Anglo-American corporate governance model, such as independent directorships, audit committees and shareholder election of directors. Yet full adoption of this model across the corporate sector may not be possible given the concentrated ownership profile of most Malaysian listed corporations.

Country overview

Philippines

"We must brace ourselves for the fact that in the new environment in which we must operate, the bar or standard of performance has been raised for Asian enterprises. This we can ascribe partly to the (Asian) crisis, and partly to the forces of globalization."

Jaime Augusto Zobel de Ayala, President Ayala Corporation

From a speech to the Asia Society's 10th Annual Corporate Conference in Asia, Manila, February 25, 1999.

Introduction

Corporate "governance" in the Philippines has traditionally meant a routine, opaque and often stage-managed process by which boards rubber-stamp a dominant shareholder's decisions. Still today, most boards are tightly controlled by insiders and family interests, CEOs and senior executives are typically family members, and shares of many publicly listed companies are not widely traded. Yet as a result of recession and globalization, this landscape is changing for the better. New rules and financing channels are starting to give outside directors and minority shareholders a voice at the table. There is a growing awareness that significant structural change is needed, among both state-owned and private companies, if the Philippines is to attract the foreign capital it needs for sustained development. Change may be slow, but a process of reform has been set in train that will be hard to stop.

Catalysts for change

There have been a few highly visible catalysts for this evolution. During the 1980s, government- initiated reform of the banking sector triggered an awareness of the need for accountability in corporate boardrooms. Around the start of this decade, an economic recession led to shareholder concerns about performance and opened many boardrooms to intense internal scrutiny. The same pattern has been repeated since the start of the Asian financial crisis. Few ownership blocks, even those held by families, are able to remain monolithic once a company's assets plummet in value.

The evolution in governance will also be driven by the following factors:

- Generational change and the fragmentation of big ownership blocks;
- Competition and operating imperatives that create a demand for capable professional advisers;
- More stringent oversight requirements imposed by some providers of capital;
- Globalization and the adoption of higher business standards;
- A higher "cost of entry" into the public equity markets (including stricter disclosure requirements, greater attention from analysts, and public "score-keeping" of stock prices);
- Changes in government and the attendant reshuffling of corporate boards on which government interests are represented; and
- The Philippines' greater dependence on foreign capital because of a lower savings rate than other Asian countries, as well as a weaker public revenue base and an enormous backlog of required infrastructure investment.

Some discipline has been established by the country's community of analysts and brokers, although this mainly applies to the larger and more liquid listed companies. Pension funds, mutual funds and sundry investors account for significant holdings in the Philippine market, but differences are normally worked out quietly and not recorded in board minutes. Nevertheless, as the quality and professionalism of investors increases, so does the pressure on boards of directors for improved corporate performance.

New developments

These factors all contribute to heightened interest in corporate performance and a greater sense of accountability in boardrooms. Some recent examples lend credence to this argument. The greatly improved results of San Miguel Corporation (www.sanmiguel.com.ph) have been interpreted by some as demonstrating that a board-initiated change of management in 1998 was an inspired example of Philippine corporate governance (Eduardo Cojuangco, a close associate of President Joseph Estrada, took over as chairman and CEO from Andres Soriano III). Although the change in leadership was perceived as influenced by political, rather than commercial considerations, the weak performance of San Miguel prior to this time probably accelerated the process. It is to be hoped that the company's board continues to remain actively engaged in guiding the company forward.

In the case of Belle Resources, the board representation of the management of the company was removed by a coalition of minority ownership interests. These shareholders acted because they were unhappy about the direction the company had been taking and, in particular, about a lack of transparency in recent acquisitions.

Another interesting example is that of RFM (www.rfm.com.ph), a diversified food and beverage conglomerate, in which Warburg Pincus and Argosy Partners Inc recently bought a stake. For the first time, the controlling family has allowed minority shareholders in at the holding company level. This means the two investors are able to participate at the board level and actively observe management. RFM is also committed to improving the transparency of its disclosures and business affairs (it will issue US GAAP notes in twice-yearly full audits).

While progress is being made, the Philippines remains a long way from the Anglo-American model of activist and accountable corporate governance. In most companies, corporate governance resembles the more reserved Continental European model, with a mix of the opacity, intransigence, incompetence and larceny found across much of corporate Asia in recent decades.

Indeed, a "shareholder activist" in the mold of the Californian Public Employees Retirement System (CalPERS) has not emerged in the Philippines. Nor is it likely to do so in the near future, since the boards of public pension funds largely comprise political appointees who change frequently and are seldom able to provide good oversight.

Obstacles

Significant hurdles remain in the development of truly transparent and accountable corporate governance regime. Foremost among them will be:

- The slow pace of market development and sophistication.
- The lack of a framework of supportive regulation.
- An ineffectual private- and public-sector organizational and professional infrastructure. .
- Cultural factors.

Market development refers to the liquidity, transparency, and modernity of the local capital market, as well as the sophistication and transparency of performance measurement and compensation mechanisms. The closer the Philippine market approximates that of the West, the more difficult it will be for listed companies to avoid close external scrutiny and the greater the legal liability for inattentive or incompetent boards. At the same time, compensation strategies that align the interests of boards and senior management with all shareholders give boards less scope to protect a narrow set of interests only.

But the Philippines is still perhaps five to ten years away from this level of sophistication. Stock-option plans and innovative fixed-variable compensation systems are only starting to take hold, and information and measurement systems are just now being modernized. The discipline imposed by vigilant—often foreign—investors is only slowly being felt, while public disclosure of and measurement against quarterly income and growth targets/forecasts has started in some companies.

Supportive regulation refers to a whole range of legal enablers and safeguards that allow freer, fairer, more transparent and more orderly business conduct. Such regulation could include stronger investigative and prosecutorial teeth for the Securities and Exchange Commission (www.sec.gov.ph) and more transparent rules for the stock exchange, with greater oversight by an independent regulator (a role played by both the commission and the stock exchange, which is self-regulating as regards its own operation). It could also involve revisions to relevant securities, corporate and criminal codes in order to cut red tape, increase minority rights, and more clearly define civil and criminal liability. Stronger regulatory frameworks for free and fair trade are needed as well, as are accounting standards aligned with those in the US and UK, and more modern bankruptcy laws that allow for quicker action on creditor rights.

But better regulation will prove ineffectual without improved **public- and private-sector organizational and professional infrastructure**. Regulatory and revenue agencies—including the Securities and Exchange Commission, Bangko Sentral ng Pilipinas (the central bank), the Department of Finance, and the Bureau of Internal Revenue—are widely regarded as inadequate, ineffective or corrupt, while the system of civil and criminal jurisprudence in the Philippines is generally seen as ineffective. Although the courts could clearly be improved, attention must also be paid to raising the quality, integrity and professionalism of private lawyers. Meanwhile, instances in the past of negligence by auditors indicates that there is a need to make them more accountable to shareholders.

Cultural factors could also impede the development of corporate governance standards. These are manifest in the Filipino tendency to avoid conflict and defer to those in authority, in the tendency to avoid loss of "face", and in the extent to which "utang na loob" or a sense of personal indebtedness to others can override professional, commercial or even legal considerations.

In traditional family owned companies, meanwhile, there is often a lack of familiarity with transaction structures and corporate finance, as well as a distrust of financial advisers and lawyers. At times this has made it difficult for direct investors to finalize even the broad outlines of a deal. Family owners often try to limit outside involvement by restricting the volume of shares to be sold publicly to a specific minority percentage. Or they may be unwilling to embed "super-minority" rights in a shareholders agreement that would give direct investors an effective veto over certain key strategic, operational and legal decisions. This is because many of them believe that "owners" (ie, themselves) take precedence over "investors" (any new shareholders) whatever the relative holdings of all parties. They think that major strategic and operational decisions remain the prerogative of the CEO or the family. A company's professional management (if it exists) is not an active participant in the decision-making process—it is there to execute the owner's directives. Yet if something goes wrong, it is likely to be blamed.

For all these reasons, the practice of corporate governance in the Philippines is unlikely, in the short- to medium-term at least, to duplicate the model of board activism set in the US and the UK.

Government ownership

The government not only has a clear monopoly on regulatory authority—and hence a responsibility for making many of the necessary changes described above—it also functions as a shareholder in many corporate entities. One group includes public pension funds, such as the Government Service and Insurance System (which serves the civil service and the social security system) and the Retirement and Separation Benefits System (for the armed forces). Another group is made up of companies that the government retains a stake in, such as privatized former state entities like Petron and the Philippine National Bank, or has partially confiscated, such as San Miguel.

The government, therefore, has a crucial role to play in encouraging the development of corporate governance. Its appointees must set an example as responsible board members by acting competently, practicing accountability and transparency, and not engaging in politics.

Unfortunately, the government's record on these matters is inconsistent at best. The implication is that progress towards higher standards of corporate governance will be slow until it appoints competent individuals to sit on boards (unlikely in the near future) or divests itself of commercial interests, or both.

The impact of privatization on corporate governance depends largely on who buys the assets. National Steel fell apart in foreign hands after privatization. The Philippine National Bank fared no better on its own after listing. Philippine Airlines is sputtering along with government help. The key appears to be strong management taking over after privatization, and then showing an interest in proper board governance.

The future

Despite all these problems, many people realize that the ability to attract and sustain the interest of foreign investors is often highly correlated with large valuation premiums on the stock markets. Observe the multiples that San Miguel, Ayala Land Inc, the Bank of the Philippine Islands and a few other well-regarded local stocks can command over comparable issues. The operative word is "sustain", since it is in building and sustaining fundamental value creation that properly constituted boards can play a valuable role.

Going forward, corporate governance in the Philippines is more likely to resemble, than mimic, the norms, values and practices of the West. Like much of modern Filipino culture, it will borrow heavily from what is available overseas, especially in the US, while retaining a cultural flavor that is unique.

Country overview

Singapore

"If you have a Titan sitting at the chairmanship of the company who is also the CEO and things come up before the board for decision, it's very difficult for the directors to question the management on certain issues."

S. Dhanabalan, Chairman, Temasek Holdings
In an interview with The Straits Times and the Business Times, 25 June 1999.

Introduction

While Singapore always fares well in global competitiveness rankings—it usually comes first in the annual World Economic Forum survey—the one area in which it consistently lags behind developed countries is corporate governance. One of the reasons for this is that much of the regulatory framework in Singapore remains based upon outdated notions of governance which blur the line between the guiding role of the board and the executive role of management.

The framework has been built piecemeal and contains some missing pieces, one of which is the lack of a general requirement in the listing rules or Companies Act that public companies appoint non-executive and independent non-executive directors to their boards. Although in practice they do—audit committees became mandatory in 1989 and must comprise a majority of independent directors—it is generally felt that, in line with international standards, the status of non-executives and independents should be clarified and enhanced.

The Singapore government is addressing these issues. It recently appointed three committees to examine how to bring governance standards more in line with international best practice, and has also made nomination and compensation committees compulsory for banks.

Catalysts for change

The Singapore market suffered a jolt in 1985 as a result of the financial collapse of the listed Pan-Electric Industries Group, a major diversified conglomerate, which used its many subsidiaries to cover the tracks of its directors and managers. The collapse triggered a crisis and forced the closure of the Stock Exchange for three days.

This incident brought about a re-evaluation of the rules governing listed companies and the safeguards for investors. As a result, capital requirements were raised above international standards and brokers were discouraged from pursuing multiple business activities within the same corporate entity (a measure aimed at reducing risk that has worked well: since the mid-1980s no broker has defaulted and Singapore's reputation as a well-regulated market has risen). More significantly, audit committees became compulsory as early as 1989 (see the box on the next page).

The main regulatory bodies with responsibility for corporate governance include the Monetary Authority of Singapore (www.mas.gov.sg), the Registry of Companies and Businesses, the Securities Industry Council and the Singapore Exchange (www.ses.com.sg). The Exchange was incorporated on 1 December 1999 following the merger of the Stock Exchange of Singapore and the Singapore International Monetary Exchange.

In tandem with the region, the Singapore government has raised the status of corporate governance reform since the Asian crisis. The Monetary Authority, for example, is directing banks to raise governance standards so as to enhance their international competitiveness (see "New developments" below).

Professional associations, in particular the Singapore Association of the Institute of Chartered Secretaries and Administrators (www.saicsa.org.sg) and the newly formed Singapore Institute of Directors (www.sid.org.sg), are also acting as catalysts for reform.

The association of chartered secretaries (SAICSA) was established in 1956 and conducts examinations for people wishing to qualify as chartered secretaries.

It also runs continuing professional development programmes for its members and has adopted, with some modifications, the professional code of conduct of the UK Institute of Chartered Secretaries and Administrators.

SAICSA extends it training programmes to company directors and other professionals wishing to keep abreast of changes in legislation and practice. It works closely with regulatory bodies to promote best practices. It was invited to nominate a member to the council of the Institute of Directors. And it publishes a newsletter, "The Chartered Secretary", the most recent issue of which can be downloaded from its website.

The Institute of Directors was incorporated in July 1998 in direct response to the Asian crisis and the subsequent exposure of poor governance standards around the region. In late 1999 it completed its own "Code of Professional Conduct for Directors" and is working on a more general "Code of Best Practices in Corporate Governance". The institute ran its first company directors course over September-December 1999, and its second from January to March 2000. It also publishes a newsletter, "The Directors' Bulletin".

New developments

In July 1999, the Monetary Authority of Singapore announced that banks must form nomination and compensation committees as part of a plan to raise their governance standards to international levels. This is being done within the context of a five-year bank liberalisation programme and the removal of a 40% limit on foreign ownership.

The guidelines stipulate that nomination committees must comprise at least five directors, the majority of whom must be independent (ie, not related to or employed by substantial shareholders of the bank; shareholders who hold 5% or more of the share capital will be deemed to be "substantial").

In response, four major banks—the Development Bank of Singapore (DBS), the Overseas Union Bank, the Overseas-Chinese Banking Corporation and Keppel TatLee Bank—had formed their nominating committees by mid-January 2000.

In December 1999, the government set up three private sector-led committees to carry out a comprehensive review of issues relating to disclosure

Audit committees in Singapore

Audit committees became mandatory for publicly listed companies in Singapore in 1989. The committee must be appointed by the board of directors and should comprise no less than three board members. Independent non-executive directors should form a majority.

All listed companies in Singapore now meet this minimum requirement. Most audit committees have three members (and two independent directors), although some have five members (and three independents).

The audit committee performs three functions. It:

- Reviews the external auditor's work and supervises the company's internal audit and accounting procedures.
- Nominates the external auditor.
- Decides other areas of responsibility with the board of directors.

In late 1996 the stock exchange sought to strengthen audit committees by introducing Chapter 9B into its Listing Manual and making its provisions mandatory. Chapter 9B covered the detailed workings of these committees: their establishment, membership, roles and duties. But following consultation with listed companies in 1998, the exchange decided to recast these rules into guidelines and transferred them to a Best Practices Guide outside the Listing Manual (thus removing their compulsory nature). This did not, however, alter the fundamental principle that every listed company must have an audit committee with a majority of independent members. The change instead allowed for procedural variation in the way the committees were run.

and governance. The three committees, and their areas of focus, are:

- **The Committee on Company Legislation and Regulatory Framework** will review Singapore's corporate law and regulatory framework, comparing these with standards and best practices in major overseas jurisdictions. It will look at the structure and composition of the Companies Act and its relationship with other statutes that influence corporate governance standards. It will propose measures to improve efficiency and cut red tape.
- **The Committee on Disclosure Standards** will review the process by which accounting standards are set, maintained and regulated in Singapore, taking into account best practices elsewhere. It will review best-practice disclosure requirements. Listed companies will be encouraged to adopt, by early 2000, best practices laid down by the International Accounting Standards and the US Generally Accepted Accounting Principles.
- **The Corporate Governance Committee** will review corporate governance best practices and examine how to adopt international best-practice benchmarks in Singapore. It will also look at promoting best boardroom practices and improving the training of company directors.

The review is sponsored by the Ministry of Finance, the Monetary Authority and the Attorney-General's Chambers. The three committees will complete their work and submit recommendations by the end of 2000.

Obstacles

Given the central role that the government plays in the economy—through its ownership of large "government-linked companies"—there are few obstacles to the formal adoption of higher corporate governance standards in Singapore. And unlike some parts of Asia, private companies seem less interested in resisting change. This may be because Singaporean companies mostly entered the Asian crisis—and survived it—in better shape than Southeast and North Asian firms. The impact of further governance reform on incumbent managers and owners, therefore, will probably be much less dramatic than in places like Korea or Thailand.

Singapore is not without its problems, however. Issues that require attention include the role of the chairman/CEO, the relationship between the board and management, and the structure of the board itself.

Temasek Holdings (www.temasek.com.sg), the government's huge investment holding arm, held a retreat in 1999 to discuss how to move forward in this area. In an interview with The Straits Times and its sister publication, the Business Times, on 25 June 1999, Temasek's chairman, S. Dhanabalan, said the company planned to implement five governance reforms across its wide portfolio of companies (which account for around 25% of the total market capitalisation of the Singapore stock exchange). It would:

- Separate the functions of chairman and chief executive.
- Limit the tenure of chairmen and board members to two terms of three years each (although in special cases this may be increased to three terms).
- Rotate chairmen and directors, where appropriate.
- Limit the number of principal directorships for each director to six.
- Set new performance benchmarks based on "shareholder value-added" (ie, "economic value-added") for all Temasek companies.

Mr Dhanabalan said of the chairman/CEO issue: "We think it's important to separate the two. We know there are both patterns in America, but where you have a CEO who is the chairman, very often the board will find it very difficult to go against the wishes of the CEO. Whereas if the chairman is independent, it's much easier for the board of directors to exercise control over the management." He added that Temasek had no intention of making this change overnight, but would act whenever the opportunity arose, such as when people retired.

Other obstacles to effective corporate governance include indifference on the part of some managers and directors, and insufficient training and education. There is a view among certain professionals in Singapore that the demand for higher standards and greater transparency is not as strong as it needs to be, and that the problem lies not with the government but with individuals running companies. While more training can help to improve the situation, a new mindset is also required.

The government's view, as expressed by finance minister, Richard Hu, is that the government can only do so much to raise standards through regulation. "The key in the race to position ourselves as a world-class business centre lies in the strength of our partnership with the private and people sectors. A strong, flexible and responsive regulatory environment should work hand-in-hand with enterprising capital and a vibrant civil effort that demand high standards of disclosure and accountability," Mr Hu said in The Straits Times on 17 December 1999.

The future

Given Singapore's status as a financial center, and with the strong support of the government and major government-linked companies, corporate governance will remain firmly on the agenda into the future. Following the completion of the comprehensive review by the three private sector-led committees by the end of this year, it seems likely that Singapore's governance framework will more closely resemble developed-country models (namely the Anglo-American version). But as the Temasek example shows—and partly because Singapore started down this road earlier than most Asian economies—the extent of change is likely to be incremental rather than radical.

Country overview

Taiwan

"I feel lonely. People look up to me for decisions. They think I know everything. But I do not. I am a king in their eyes. So I hate to disappoint them by telling them I really do not know the answer. At times I just have to give it my best shot and live with the results. But there is no one I can turn to for consultation. And I cannot discuss specific problems with other CEOs for confidentiality reasons."

CEO of a listed company, Taipei
From a discussion with a foreign investor, July 1999,
explaining why he would welcome outside directors on his board.

Introduction

Corporate governance reform faces some deeply entrenched obstacles in Taiwan. Modern notions such as minority shareholder rights and board independence do not easily penetrate the formidable walls of Taiwan's family companies. The government's strongly interventionist policies continue to favor dominant "owner-entrepreneurs" and state-owned companies at the expense of other shareholders and stakeholders. Over-regulation of the stock market and a lack of information make it difficult for investors to discriminate between companies on corporate governance grounds. And both the banking and judicial systems have a long way to go before reaching the levels of sophistication required by modern capital markets.

Yet various counter-balancing forces are at work. For example, some government bodies, professionals and academics have begun promoting greater accountability and transparency. While shareholder activism may not yet exist, institutional investors are starting to take an interest in these issues. Taiwan companies facing tough global competition increasingly realize that they need to reshape their strategies and strengthen internal management structures.

Catalysts for change

In contrast to many parts of the region, the Taiwanese economy did not go into recession in 1998 as a result of the Asian financial crisis. Taiwan's corporate sector and its banking system were somewhat cushioned from the sharp downturn in the regional business cycle. This has meant that pressure for corporate governance reform in Taiwan, such as it exists, is much weaker and less focussed than in the rest of Asia.

Nevertheless, an effort to promote corporate governance is gradually coalescing around certain statutory authorities, professional groups and academic institutions that support an open, market-based economic system over an interventionist, state-directed one. The key public actors are the Securities and Futures Commission (www.sfc.gov.tw) and the Taiwan Stock Exchange (www.tse.com.tw), whose joint aim is to enhance market integrity by strengthening their own regulatory and market-monitoring functions. Groups of lawyers and academics are contributing by helping to rewrite the Company Law and the Securities and Exchange Law. And some professional associations, notably the Institute of Internal Auditors of Taipei, are becoming active in this area.

Major targets of the securities commission and the stock exchange are illegal practices such as insider trading and self-dealing (which includes things like the use of subsidiaries to trade in the shares of a parent company, with the aim of boosting the parent's share price). In the primary market during 1998, the exchange performed a number of extra-ordinary audits, reviewed numerous financial reports and monitored several thousand cases of insider stock transfers. Market surveillance in the secondary market was also quite extensive, while the stock exchange performed several hundred audits of securities firms. During the same year it revised procedures governing "significant event announcements" so that listed companies could make initial statements over the Internet and improve the timeliness of their information distribution.

A broader catalyst for reform has been the ongoing liberalization of Taiwan's securities markets. The government still hopes to promote Taiwan as a regional business hub and financial center, an idea first proposed in 1995. Yet this cannot happen without significant relaxation of laws governing foreign investment and operation of securities firms (see box on the next page for a summary of developments).

Although few obvious examples of good corporate governance practice exist, a trend favoring it has emerged: high-tech companies facing global competition have become barometers of good practice, precisely because they are subject to high international standards and expectations, and because, lacking collateral, they can only source financing on the strength of their ideas, intelligence and transparent management structures. The same competitive forces have caused some owners to encourage employee stock ownership, although this has had a mixed result: while it diffuses ownership concentration, it can also dilute the interests of financial investors.

Another trend is apparent among some of the country's more international companies: while not using the language of corporate governance, they are in many ways following sound governance practice. Acer (www.acer.com.tw) the country's biggest computer manufacturer and exporter, recently appointed a new non-executive director who brings substantial external expertise to its board. And its Internet website discloses a large amount of information regarding recent and historic financial performance, the company's evolving corporate strategy, as well as new business deals and strategic alliances. Another firm spoken of as having good governance is Taiwan Semiconductor Manufacturing Corporation (www.tsmc.com.tw).

There are also indications that foreign institutional investors are becoming more interested in corporate governance. While they account for an insignificant volume of securities trading in Taiwan, it is understood that such investors engage in "invisible activism". That is, they seek to change management behavior by talking privately to listed companies about problems, rather than attacking them publicly or taking legal action (a last resort).

Obstacles

The government's interventionist mindset and its stability driven, pro-growth policy pose major obstacles to corporate governance reform, in particular shareholder activism. The reasons are as follows:

- Government intervention in the economy through state-owned companies and in the capital markets typically favors the current management of companies (usually dominant "owner entrepreneurs") over activist minority shareholders. The government believes that owner-entrepreneurs should not be easily challenged, both because economic growth could be undermined if they are and because it has traditionally taken the side of industry. Another factor is that shareholder activism acquired a bad name in Taiwan a few years ago when certain corrupt politicians and gangsters tried to manipulate shareholder meetings for their own (greenmail) ends. The government was forced to crack down on these practices.

  Some anecdotal evidence suggests that ownership concentration does produce better operating results. Yet benefits will not accrue to minority shareholders if profits are diverted through related-party transactions (which are common when there are no checks and balances against a controlling shareholder).

- Over-regulation of the capital market has prevented the price discovery mechanism from playing a more important role in evaluating corporate performance. Because of insufficient information and regulations such as the imposition of daily limits, stock prices tend to be either too high or too low. Hence, investors find it difficult to use prices to differentiate between companies with good and bad corporate governance practices.

- Over-regulation of the banking sector and the difficulties faced by foreign banks in making inroads in recent years (despite market-opening efforts) have limited bargaining between lenders and borrowers. Local banks continue to rely heavily on collateral and relationship banking, which discourages them from challenging powerful corporate borrowers (or their owners).

- Courts are poorly equipped to deal with corporate governance issues, especially problems like related-party transactions. People become judges immediately after law school and so have little practical business or career experience. They are also far too busy to deal with any single case adequately.

- Legislators are inefficient and prone to capture by interest groups. As a result, they have not legislated to improve corporate governance standards.

Government ownership

Although the state-owned sector accounts for a relatively small portion of Taiwan's GDP, state ownership is relevant to this debate in a qualitative sense. Since many important public utilities and financial institutions are state-owned, the government is often tempted to adopt special rules so as to prevent corporate governance principles from having a fuller impact on these companies. For example, state corporations are exempt from a rule that requires private companies to go public once their paid-in capital reaches NT200 million (US$6.3 million at current exchange rate).

The future

The influence of the Anglo-American model of corporate governance in Taiwan remains extremely limited. In addition to the factors already listed, an

Securities market liberalization in Taiwan

Taiwan has taken a strictly gradualist approach to liberalizing its securities markets. Foreign institutional investors were first allowed to invest in 1990, but kept under tight control and subject to a maze of rules. Among other restrictions, the total amount of all such investment could not exceed US$10 billion, limits were placed upon the total that any single fund could invest in Taiwan as well as upon the percentage of equity that funds could take in any one company, and non-resident foreigners could not open local currency accounts with Taiwanese brokerages.

Many of these rules have since been loosened. The US$10 billion limit was replaced by a rule stating that all foreign institutional investment must not exceed 30% of total outstanding shares in the market. The total amount that each fund was permitted to invest in Taiwan rose from US$200 million to US$600 million, while the investment ceiling in individual companies increased to 15%. In early 1996, the Ministry of Finance allowed non-resident foreigners to open New Taiwan dollar accounts with brokerage firms through an attorney. However, the Executive Yuan, the cabinet, later revised this rule to allow direct investment by foreign individuals and institutions.

Other restrictions cancelled recently include a three-month "lock-up" period before investment capital can be remitted out of the country, and the right to remit capital gains only once per year.

Foreign securities firms, meanwhile, were first allowed to set up branches in Taiwan in 1988, but were restricted to acting as intermediaries in the trading of foreign securities by Taiwanese people. Since 1994 they have been allowed to local broking, securities financing and underwriting.

The government plans to liberalize the securities markets further. Investment limits will be raised. The criteria for setting up a securities trading operation will be relaxed and the permitted business scope of these firms increased. And foreign companies will be encouraged to list on the Taiwan Stock Exchange. The first to do so was ASE Test Ltd, a Singaporean company, in January 1998.

Whether or not Taiwan succeeds in turning itself into a regional business and financial center, the ongoing development of its securities markets will at the very least facilitate the import of international standards and principles, including those relating to corporate governance.

(Note: For further details see "The Securities Market & Its Role in the Development of the Asia-Pacific Regional Operating Center", Taiwan Stock Exchange. This document can be downloaded from: http://plan.tse.com.tw/plan_depart/publish/englishmanual/ew.htm) important reason is that the Company Law was largely based upon German and Japanese law (which is why Taiwan companies, nominally at least, have supervisory boards). The Securities and Exchange Law, in contrast, was originally patterned on US securities legislation; but American regulatory philosophy and concepts have had little impact.

Yet the importance of the Anglo-American model is likely to increase, not least because Taiwan is increasingly relying on international capital markets for long-term equity and debt funding. Given the central role played by New York and London in these markets, Taiwanese companies will embrace elements of US and UK corporate and securities regulation, if not corporate governance principles as well. Yet the extent and pace of this migration is extremely difficult to gauge.

Country overview

Thailand

"Thai banks lose money because major shareholders borrow money from their own banks. (And) because top managements borrow money from their own banks and go and sit on their borrowers' companies until they don't know where they are working or whom they are working for—the borrower or the lender."

M.R. Chatu Mongol Sonakul, Governor, Bank of Thailand
From a speech on Thai banking to the Bangkok Club, 22 July 1999.

Introduction

Like Singapore and Malaysia, Thailand effectively began its corporate governance reform process by promoting audit committees. Given the need to do something to improve its under-performing corporate and banking sectors, and with few professional and government bodies capable of playing a role, the Thai authorities concluded that audit committees would be the best place to start. Another early initiative was a "Code of Best Practice for Directors of Listed Companies", first published in December 1997.

A distinctive feature of Thai governance reform has been the government's effort—for cultural reasons—to strike a balance between devising compulsory rules and encouraging voluntarily action on the part of companies. Interestingly, Thailand also has a central banker who is particularly outspoken on the subject of corporate governance—M. R. Chatu Mongol Sonakul, Governor of the Bank of Thailand (www.bot.or.th). Overall, awareness of corporate governance is rising in Thailand, but various systemic problems must be overcome before it takes root.

Catalysts for change

In January 1998, the Stock Exchange of Thailand (www.set.or.th) notified listed companies that they would have to form audit committees no later than December 1999, while newly listed companies would require them from the start. Such committees should comprise at least three directors, all of whom should be independent and at least one must have expertise in accounting or finance. The Stock Exchange of Thailand (SET) also instructed companies to include a report of the committee's supervisory activities in their annual reports. As of November 1999, 170 companies (out of almost 400) had complied, including well-known companies such as Thai Danu Bank, Siam Cement, Siam Commercial Bank, Thai Farmers Bank, and PTT Exploration and Production.

The audit committee policy was championed from the beginning by The Institute of Internal Auditors of Thailand (IIAT), one of the most proactive organizations in Thai corporate governance reform. IIAT was instrumental in putting this idea on the agenda through a study it carried out for SET. After audit committees became mandatory, the government decided to apply the policy to all ministry level bodies and state enterprises, and to improve its own systems of internal auditing.

Over the past two years, SET and the Securities and Exchange Commission (www.sec.or.th), the market regulator, have laid down additional rules. For example, both listed companies and those undertaking initial public offerings must have at least two independent directors on their boards, while newly listed companies must have an internal audit department before going public. The authorities have also recommended that companies form nomination and remuneration committees.

In 1998, the securities commission (SEC) formed a working group to study corporate governance and clarify lines of responsibility between related regulatory agencies and professional bodies. The group included the Ministry of Finance, the Ministry of Commerce, SET, the Institute of Certified Accountants and Auditors of Thailand, and the Institute of Internal Auditors of Thailand. The issues studied include:

- The possibility of allowing groups of small shareholders to instigate class action lawsuits against management.
- The appropriateness of the two-tier board structure

(to enhance board independence).

- The improvement of the proxy voting process.

The Thai authorities are keen to promote voluntary action on corporate action in order to balance the compulsory nature of their new rules. The rationale for this approach was explained by Dr Prasarn Trairatvorakul, deputy secretary-general of the SEC, in a speech in Singapore in 1998: "Though the regulatory requirement is necessary to establish good corporate governance, it has certain limitations. The formal enforcement mechanism is often costly, time-consuming and inflexible. Besides it may be met with resistance from the regulated. Thus, we consider the "voluntary approach" a complementary means to promote good governance." Prasarn said this way seemed "to suit the Thai culture best".

The main channel through which this is being done is investor and company education. Numerous organizations are involved. The SEC, in conjunction with tertiary institutions, organized two seminars aimed at investors during 1998. The stock exchange has been even more active: it has run seminars on a range of topics, including improving the quality of audit committees and the role of directors, and has organized meetings between investors and the management of listed companies. The Institute of Internal Auditors, meanwhile, ran an intensive course for 3,000 people in 1999. Its officers speak regularly to Thai companies and write for newspapers, and it hosts a television programme called "Transparency 360 Degrees". The institute also hosted a major international conference on corporate governance and internal auditing in Bangkok in mid-November 1999 and, at the same time, launched the country's first best-practice award scheme.

New developments

Reform efforts moved forward again, albeit gradually, with the announcement of two new developments on October 1, 1999. The first was the release of a new draft framework on good corporate governance for listed and unlisted companies, and state enterprises. Devised by the Committee on Good Corporate Governance Development, which was established by SET in 1999 and chaired by a former central bank governor, Chavalit Thanachanan, this comprehensive code of best practice aims to adapt governance concepts to the Thai context. The committee has been conducting hearings before finalizing its guidelines and will later submit them to the SET Board of Governors. Initially, compliance will be voluntary.

The second new development was SET's formation of an Institute of Directors, which has been given the task of raising professional standards among company directors. Like its sister bodies around the world, the institute will run training courses and seminars, offer memberships to directors who pass certain criteria, and develop a list of people capable of acting as independent directors. The Institute is being funded in cash and in kind by a number of domestic and international bodies, including SET, Bank of Thailand, SEC, and the World Bank.

Obstacles

There are various explanations as to what are the main obstacles to corporate governance reform in Thailand. Some emphasize rigid thinking, which is partly a function of insufficient education. "Most people think corporate governance is a fashion or a necessary evil, which is not true," says Kiattisak Jelatianranat, chairman of the Institute of Internal Auditors (and a founding board member of the Asian Corporate Governance Association). Mr Kiattisak believes that this attitude is prevalent in government as well as business.

Dr Prasarn of the SEC outlined a range of legal problems in a recent speech in Bangkok in September 1999. Referring to a section of the Thai Public Company Act stating that company directors should act with "care and honesty", he noted that there had been few court cases that had demonstrated what this meant in practice. Small investors seeking redress and compensation through the courts faced the "free-rider" problem: all shareholders would benefit from any successful action initiated by a few (although this problem is not, of course, limited to Thailand). Moreover, the SEC lacked sufficient power to prosecute directors who breached their duties. Take a common example like improper cross-party transactions, a form of fraud. Because this is a criminal offence, the SEC must prove beyond reasonable doubt that there is an intention to defraud a company—something that is extremely difficult to do. Dr Prasarn said that "it takes a long time, if ever, to proceed and win the case".

The most critical assessment of Thailand's ability to adapt comes from Chatu Mongol Sonakul, Governor of the Bank of Thailand. Attacking inflexible mindsets, legal problems and other systemic issues, Mr Chatu told Thai bankers in mid-1999 that they quickly had to "wake up" and learn to compete against the international giants—or they would not survive. "To be competitive one must have good products, have good control and good corporate governance," Mr Chatu said. Most Thai banks failed on all three counts. Resolving these problems, he said, would require changing the way the central bank worked as well as urgent action on the part of commercial banks. "Our strategy is to try and put competition in and to ready the commercial banks for good governance with ability (sic) to have initiatives and to assess risk properly," he said.

The future

Despite deeply entrenched problems, there are many reasons for being optimistic that corporate governance reform will steadily take root in Thailand. The current Thai government has advocated and promoted it as a way to improve the operating efficiency and effectiveness of companies. Education and promotion—critical to changing the mindsets of legislators, policymakers, regulators, and the public at large—are being pursued with energy by several organizations. And numerous government and business leaders clearly see it as a way to restore international trust and confidence in Thailand's economy.

The Asian Corporate Governance Association

The Asian Corporate Governance Association

Introduction

The Asian Corporate Governance Association (ACGA) was launched in Hong Kong on August 3, 1999 by a group of business leaders from seven Asian economies. ACGA is incorporated in Hong Kong as a not-for-profit organisation and is a wholly private-sector initiative.

ACGA believes that sound corporate governance will not only contribute to stronger and more modern companies and economies, it will become a fundamental prerequisite of doing business internationally in the next century.

"The globalisation of the world business system and economy means that corporate governance is an inevitable international trend," says David Chiang, founding chairman of the association.

The increasing integration of the world economy is intensifying the pressure for common standards and rules covering global trade and investment, while the dynamic growth of cross-border institutional and strategic investment (especially from the US and Europe, but also within Asia itself) is effecting change in governance practices at the individual company level in emerging markets.

ACGA's objective is to persuade Asian companies that corporate governance makes sound commercial sense. Higher levels of transparency and accountability bring easier access to international capital markets, and help to minimise both risk and the cost of capital. Over the medium term, companies with good levels of disclosure tend to enjoy stronger investor support. The checks and balances inherent in corporate governance also provide companies with better systems for guarding against internal fraud.

Indeed, in the not-too-distant future companies may be rated for their corporate governance, as well as financial, performance. "Although corporate governance is a revolutionary idea in Asia today, tomorrow it could become as widely accepted as international standards like ISO 9000," says Mr Chiang.

Mission

The mission of ACGA can be summarized by three "As": authority, advocacy, and assistance. We intend:

- To become the leading private-sector **authority** in Asia on corporate governance issues and to assess and analyse the region's progress towards these goals regularly.
- To play an ambassadorial and an **advocacy** role in promoting corporate governance at international, regional and national fora, as well as to decision-makers and thought-leaders in government, business, the media, and the wider community.
- To provide **assistance** and advice to Asian companies wishing to implement corporate governance practices within their firms.

Action Plan

To achieve our objectives, we plan, among other things, to carry out original research into corporate governance policies and practices in Asia, to create an Internet website that will become a information hub for the region, to develop an “advocacy program” of speaking engagements, and to forge links with private and public institutions active either regionally or internationally in this area.

Our detailed Action Plan for 1999-2001 is as follows:

Information

- Develop a comprehensive database on corporate governance in Asia (an ongoing project).
- Set up an Internet website for information dissemination and advice (to be completed, funding permitting, by first half 2000).
- Produce a concise comparative report on corporate governance policies and practices in Asia (ie, this report).
- Carry out a survey of corporate governance practices among major corporations in Asia (to be completed in 2000, funding permitting).

Advocacy

- Speak at regional and international conferences on corporate governance (numerous are being planned by various organisations over the next two years).
- Meet with government and business leaders, and other interested parties.
- Develop a structured, annual promotional strategy.

Education

- Forge links with tertiary educational institutions around the region for the development of long-term educational programs on corporate governance.
- Provide assistance and advice to professional bodies in the organization of training courses for board directors, company secretaries, and other related parties.

Networking/partnering

- Build alliances with key institutional, national and international organizations for the promotion of corporate governance.
- Wherever possible and appropriate, work with these organizations to achieve the objectives laid down in our Mission Statement. This approach has a threefold advantage: it ensures that we do not duplicate the efforts of others; it reduces our costs and those of others; and it will produce more effective outcomes.

Founding Board Members

ACGA's founding board members represent a range of business, professional and academic sectors. They are:

Chairman

- David Chiang, Chairman & Managing Partner,
  Lombard Asian Private Investment Company, Hong Kong

Members

- Gloria L. Tan Climaco, President & CEO, Crown Equities, Inc., Manila (former Chairman & Managing Partner, SGV & Co).

- In-Kie Hong, Senior Adviser, Korea Securities Research Institute, Seoul (former Chairman & CEO of the Korea Stock Exchange).

- Paul S. P. Hsu, Senior Partner, Lee and Li, Attorneys at Law, Taipei; Professor of Law at National Taiwan University; and a senior advisor to the Taiwan government.

- Tan Sri Abdul Rashid Hussain, founder and Executive Chairman, Rashid Hussain Berhad and RHB Capital Berhad, Kuala Lumpur.

- Kiattisak Jelatianranat, Director, Internal Audit Services, PricewaterhouseCoopers ABAS Ltd, Bangkok; and Chairman, The Institute of Internal Auditors of Thailand.

- Lawrence S. Liu, Partner, Lee and Li, Attorneys at Law, Taipei; Professor, Graduate Institute of Law, Soochow University; and an advisor to the Taiwan government.

- Deepak M. Satwalekar, Managing Director, Housing Development Finance Corporation, Mumbai, India.

- Tak Wakasugi, Professor, Graduate School of Economics, The University of Tokyo (and member of the Corporate Governance Committee of the Corporate Governance Forum of Japan).

Board Member Biographies

David Chiang

David Chiang is a specialist at building and investing in high-technology companies. A chemical engineer by training, his 30-year career spans scientific research, the commercialization of new technologies, the formation of start-up companies in Asia, China and North America, and, most recently, private equity investing in Asia. His industrial management experience ranges across several industries, including chemical and petrochemical, telecommunications, power, electronics, and packaging industries. Mr. Chiang co-founded Lombard Asian Private Investment Company in 1997 after a successful career with Raychem Corporation, which develops high-performance products for electronics, industrial and telecommunications applications.

Mr. Chiang is widely known for his efforts to promote corporate governance in Asia. Not only is he a frequent speaker at conferences on corporate governance issues and has published articles in newspapers, he was chosen as one of BusinessWeek International's "50 Stars of Asia" in June 1999. Mr. Chiang holds a Bachelor of Science degree from Chung Yuan Institute of Technology, Taiwan and a Ph.D from Laval University, Canada. He did post-doctoral study at the University of Delaware, US, and managerial studies at Cornell University.

Gloria L. Tan Climaco

Gloria Climaco has contributed greatly to both the economic and social development of the Philippines. She is currently President & CEO of Crown Equities, Inc., a holding company for private equity investments and an affiliate of Equitable Banking Corporation, of which she is also a director. Ms. Climaco is concurrently Managing Director of Argosy Partners, Inc., the largest private equity fund in the Philippines established with capital from GE Investments, Warburg Pincus and Chase. She is a member of the Board of several publicly listed and privately owned Philippine companies.

Ms. Climaco began her career with SGV & Co, where she rose to become Chairman and Managing Partner. In 1984 she was seconded to the Central Bank of the Philippines as a special consultant to the Governor. In an advisory capacity, Ms. Climaco sits on the Philippines WTO/AFTA Presidential Advisory Council Board of Trustees, and is a trustee of the Gerry Roxas Foundation and the Foundation for Economic Freedom. Ms. Climaco has received numerous professional awards and honors, including a Global Leaders for Tomorrow award from the World Economic Forum, Davos, in 1994. She holds a Bachelor of Science in Business degree from Ateneo de Zamboanga, an MBA from Northwestern University, US, and is a Certified Public Accountant.

In-Kie Hong

Mr. Hong has had a long and distinguished career in Korea's government, industrial and financial sectors. Until very recently, he was Chairman and CEO of the Korea Stock Exchange, and a member of the Executive Committee of FIBV (the International Federation of Stock Exchanges). Currently a Senior Adviser to the Korea Securities Research Institute, he is also a Visiting Professor at Myongji University Graduate School of Securities and Insurance, and an Outside Director on the board of Good Morning Securities. Mr. Hong is completing a book entitled "Corporate Restructuring and the Korea Stock Market" and is an advisory council member of the Harvard Business School's

"Global Corporate Governance Initiative". Over the past five years he has lectured about 20 times a year at seminars and advanced management programs on the importance of corporate governance.

Mr. Hong began his career in the Ministry of Finance & Economy, and later moved into the private sector, where he worked for Hanwha and Daewoo for many years. He became President of Dongsuh Securities in 1988, and President of Korea Development Securities in 1991. He holds a degree in law from the College of Law, Seoul National University, completed a financial policy course at the IMF, and undertook advanced management studies at Harvard Business School. In 1981, Mr. Hong received a Commendation Medal for Contribution to Economic Development in Korea. In 1997, he was awarded an honorary doctoral degree in economics from Kiev Slavonic University, Ukraine.

Paul S. P. Hsu

Paul Hsu is one of Taiwan's most eminent lawyers and legal thinkers. He is a Senior Partner of Lee and Li, the leading law firm in the Republic of China (ROC) engaged in international commercial practice. Widely recognized as an expert in cross-border economic and commercial transactions, Mr Hsu's areas of specialization include corporate strategic planning, Asia Pacific regional economic cooperation, intellectual property rights, and financial services. A Professor of Law at the National Taiwan University, which he joined in 1969, he has published widely on Taiwan, Greater China and international legal and economic issues.

Mr Hsu participates actively in regional and international economic institutions, including APEC, PECC, the WTO and OECD. He chairs and sits on the boards of a number of foundations and councils, including the Epoch Foundation (closely linked to MIT in the US), the Asia Foundation, and the ROC-USA Economic Council. He is also a senior advisor to the government of Taiwan. Born in Hong Kong, Mr. Hsu received his Bachelor of Law degree from the National Taiwan University, his Master of Law degree from New York University School of Law, and a Master of Arts from the Fletcher School of Law and Diplomacy, Tufts University.

Tan Sri Abdul Rashid Hussain

Tan Sri Rashid is one of Malaysia's most influential financiers and industrialists. He is the founder and the Executive Chairman of Rashid Hussain Berhad (RHB), a diversified conglomerate, and RHB Capital Berhad. He has extensive experience in the securities and fund management industry, and has been the driving force behind the recent consolidation process in the Malaysian financial services sector. In July 1997, in conjunction with an acquisition of Kwong Yik Bank, he formed RHB Capital, the leading fully integrated financial services group in Malaysia.

Tan Sri Rashid is also Chairman of Putrajaya Holdings, which is implementing the Malaysian government's plan to build a new, state-of-the-art administrative hub in Putrajaya, near Kuala Lumpur. He also sits on the board of Cycle & Carriage Bintang Berhad.

Kiattisak Jelatianranat

Kiattisak is known as the guru of corporate governance and the father of modern internal auditing in Thailand. He has long played a central role in promoting and transforming corporate governance and internal auditing practices. He continually stresses the need for good corporate governance through both his regular columns in leading Thai newspapers and a live TV program he produces/hosts on corporate governance called "Transparancy 360°". He speaks often at business conferences, and lectures at leading graduate schools in Thailand. He is the author of several books, including "Corporate Governance to Increase Competitiveness", 'The 21st Century Vision of Internal Auditing", and "Principles and Techniques of Modern Internal Auditing". He has also written more than 500 technical papers and articles.

Kiattisak currently serves as a Director, and member of the audit committee, of the Bank of Thailand. He is a member of the 'Committee on Corporate Governance Improvement' of the Ministry of Finance, and is the Director of Internal Audit Services at PricewaterhouseCoopers. Prior to joining PricewaterhouseCoopers Thailand, he worked for several large conglomerates such as Siam Cement Group, the C.P. Group, and Deloitte & Touche. Kiattisak is also a founding member of the Institute of Internal Auditors of Thailand (IIAT). During his chairmanship of IIAT (1998-99) he successfully raised the Institute's profile and professional standard of practice up to an international level. His initiatives included grandfathering the first Asia Pacific Annual Conference (APAC '99) on "Corporate Governance and Internal Auditing". He holds a Bachelor of Accounting (Honors) and a Masters of Accounting from Chulalongkorn University, Thailand, an MBA (Finance) from the University of Missouri, and a CPA (Thailand).

Lawrence S. Liu

Lawrence Liu is a leading Taiwan lawyer—he is a Partner of Lee and Li, and a Professor at the Graduate Institute of Law, Soochow University, Taipei. His areas of legal and policy specialization include competition, corporations, securities, investment, and banking. His academic interests cover, among other things, law and economics, comparative legal institutions and systems in Greater China, judicial review, international trade and finance, and firm theory. He has published widely in regional and international journals and books.

Mr. Liu has been an advisor to numerous government ministries and agencies, as well as the local and foreign business communities, in Taiwan. In 1995, he took a leave of absence to become the first Executive Director of the Coordination and Service Office for the Asia Pacific Regional Operations Center, a government initiative to integrate Taiwan more closely with other Asian economies and to enhance its competitiveness. Mr. Liu holds a Bachelor of Law degree from the National Taiwan University, a Master of Law degree from the University of Pennsylvania, and a Doctor of Law degree from the University of Chicago.

Deepak M. Satwalekar

Mr. Satwalekar is a highly regarded member of India's business community. He has played a central role in the rise to prominence of the Housing Development Finance Corporation (HDFC) since its inception in 1977. HDFC was the first institution of its kind in India and dominates the housing finance market with more than an 80% share. Mr. Satwalekar became Deputy Managing Director in 1990 and Managing Director in 1993. His responsibilities have ranged from technology application in service delivery to a shared responsibility for HDFC's expansion into new financial services, such as banking. He is currently driving the company's entry into the insurance, mutual funds and consumer finance businesses.

Mr. Satwalekar is widely sought after as an advisor to multilateral institutions, business associations and governments. He has been a consultant to the World Bank, the Asian Development Bank, the United States Agency for International Development, and the United Nations Centre for Human Settlements. He has chaired or been a member of numerous business- or government-initiated committees covering issues such as insurance, infrastructure, urban development, and privatization. He has also been a speaker at both national and international conferences, and management schools in India. Mr. Satwalekar holds a Bachelor of Technology degree from the Indian Institute of Technology, Bombay, and an MBA from The American University, Washington, DC.

Takaaki Wakasugi

Professor Tak Wakasugi has been closely involved in corporate governance issues in Japan in recent years. As a member of the Corporate Governance Committee of the Corporate Governance Forum of Japan, he contributed to the development of "Corporate Governance Principles—A Japanese View", a code of best practice published by the Forum in May 1998. In his professional capacity as Professor of Finance at the Graduate School of Economics, University of Tokyo—and previously as an associate professor at Yokohama City University and the University of Tohoku—Professor Wakasugi has published widely on Japanese corporate finance and capital markets. Two of his main publications include "Theory of Corporate Finance" (1988) and "Investment Strategy of Corporate Pension Funds" (1997). At present, he is also Co-Director of the Mitsui Life Financial Research Center at the University of Michigan Business School, President of the Japan Financial Studies Association, and a director of Nippon Finance Association.

Professor Wakasugi also advises the Japanese government on financial policy. He is an advisor to the minister of finance on the Government Policy Investment Council, and an advisor to the minister of posts and telecommunications on the Post, Savings and Insurance Council. He has chaired many study groups at the Ministry of Health and Welfare, and at the Ministry of International Trade and Industry. And he has contributed to the development of the Japanese securities industry by sitting on the Securities Policy Board of the Tokyo Stock Exchange and acting as Director of the Japan Securities Research Institute.

Secretariat

The ACGA Secretariat is headed by Jamie Allen, Secretary General. His contact details are:

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Fund Raising

ACGA is actively seeking companies and institutions interested in becoming founding sponsors of the association. The general benefits of sponsorship are far-reaching. For example:

➢ An association with ACGA will allow your organization to position itself at the forefront of the drive for better corporate governance practices—a prerequisite for stronger boards and companies, as well as more efficient capital markets and economies, throughout Asia. As a non-profit organization formed by the private sector, ACGA is uniquely placed to offer an independent and credible commercial voice to the corporate governance debate.

➢ ACGA can provide a channel for your own corporate governance work to become better known to investors—institutional or individual—as well as to governments and the media.

➢ Being a sponsor will also raise your profile among ACGA's steadily growing network of business leaders, companies, consultants, multilateral lending institutions, professional associations, regulatory authorities, and university business schools.

For information about the wide range of specific benefits available to sponsors, please contact the Secretariat.

Founding Sponsors

ACGA is pleased to acknowledge the generous financial support of the following organisations:

- **Lombard / APIC (HK) Ltd**

Lombard/APIC is a Hong Kong-based investment management company established in 1997. It manages Lombard Asian Private Investment Company LDC (LAPIC), a US$250 million private equity fund whose main investors include the Californian Public Employees' Retirement System and the Asian Development Bank. LAPIC focusses on developing economies in Asia and invests in established Asian companies with significant growth potential.

- **Good Morning Securities, Seoul**

Good Morning Securities (formerly Ssangyong Investment & Securities Company) is one of Korea's largest brokerage firms. Its vision is to become a first-rate provider of investment services and advice, operating to global standards and having the financial prowess to meet the diverse demands of its clients. It is leading the way in corporate governance reform in Korea.

- **Housing Development Finance Corporation Limited (HDFC), Mumbai**

HDFC is India's largest residential mortgage finance institution. Incorporated in 1977, it was promoted by ICICI, with initial equity investments from the International Finance Corporation (Washington) and the Aga Khan Foundation. HDFC was the first institution of its kind in India and is a leader in the field of corporate governance.

Further acknowledgement

ACGA also wishes to thank the Horwath Hong Kong Group for its assistance in the incorporation of the association in October 1999. Horwath Hong Kong is part of Horwath International, a network of more than 100 independent accounting and management consulting firms spanning 90 countries.

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