Asian Corporate Governance Association (ACGA)

"Corporate Governance in Asia: How VC Funds and Directors can help to Manage Governance Risks"

Presentation by

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Agenda

1. Rating Corporate Governance Quality in Asia
2. How VC Funds and Directors can Help to Manage Governance Risks (before IPO)
3. Conclusion

Introducing ACGA

- The Asian Corporate Governance Association (ACGA) was formed in 1999 to support the implementation of effective corporate governance in Asia. Our scope of work covers research, advocacy and educational events in 11 Asian markets.
- ACGA is incorporated in Hong Kong as a non-profit association and is independently funded by a corporate membership base.

1. Rating Corporate Governance Quality in Asia: ACGA – CLSA "CG Watch" Survey

Market	2004[1]	2005[2]	2007[3]
1. Hong Kong	67	69	67
2. Singapore	75	70	65
3. India	62	61	56
4. Taiwan	55	52	54
5. Japan	-	-	51
=6. Korea	58	50	49
=6. Malaysia	60	56	49
8. Thailand	53	50	47
9. China	48	44	45
10. Philippines	50	48	41
11. Indonesia	40	37	37

1. Introduced a detailed survey and scoring methodology in 2004.
2. Made the methodology more regorous in 2005.
3. Enhanced the methodology further in 2007. (No survey in 2006.)

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

Why scores in "CG Watch 2007" were lower

- Methodology became more rigorous
- "The more we looked, the less we found"
- Varying degrees of regulator, issuer and investor complacency in booming markets
  - "The job is done, we now just need to refine the rules"
- Political paralysis (eg, Korea) or upheaval (eg, Thailand)
- Accounting + auditing standards & practices lagged international norms more than expected (in many markets)

"CG Watch 2007" category scores (%)

Market	CG Rules & Practices	Enforcement	Political/ Regulatory	IGAAP	CG Culture	TOTAL
1. Hong Kong	60	56	73	83	61	67
2. Singapore	70	50	65	88	53	65
3. India	59	38	58	75	50	56
4. Taiwan	49	47	60	70	46	54
5. Japan	43	46	52	72	49	52
=6. Korea	45	39	48	68	43	49
=6. Malaysia	44	35	56	78	33	49
8. Thailand	58	36	31	70	39	47
9. China	43	33	52	73	25	45
10. Philippines	39	19	38	75	36	41
11. Indonesia	39	22	35	65	25	37

Source: "CG Watch 2007", ACGA & CLSA Asia-Pacific Markets

"CG Watch 2009"

Topical issues in our next survey include:

- Are governments taking a more strategic view of corporate governance as a result of this crisis, or are they seeking expedient solutions to immediate problems?
- Are regulators removing or waiving any core shareholder rights to allow easier capital raising in response to the financial crisis?
- How sound are systems of corporate financial reporting and external auditing?
- Are listed companies seeking a more open dialogue with their shareholders and key stakeholders?
- Are shareholders exercising their ownership rights more vigorously following the crisis?
- Are directors becoming more knowledgeable and committed?

2. Managing Risk

- Types of corporate governance risk:
  1. Regulatory risk
  2. Board (under-performance) risk
  3. Organisational risk
  4. Shareholder-expectation risk
  5. Stakeholder risk

- Directors are responsible for understanding these risks and ensuring that management takes mitigating action.
- VC / PE funds can play a critical role in laying the groundwork for governance pre-IPO.

Regulatory risk

- Regulatory regimes around the world and in Asia are undergoing constant evolution:
  - **Securities laws:** In recent years, a much stronger focus on insider trading, fraud, market manipulation.
  - **Company law:** New focus on director duties, organisation of annual shareholder meetings, shareholder litigation.
  - **Listing rules:** Stricter requirements on financial reporting, independent directors, audit committees, connected transactions, voting by poll, stock options.
  - **CG Codes:** Broader and deeper "soft law" guidelines on board governance, the role of directors, and auditing.
- How many directors and managers of private companies planning to IPO understand these trends? And the regulatory and reputational risks they face?
- VC/PE funds can help to educate their investee companies about regulatory change before an IPO.

Hong Kong's rising regulatory bar has not impeded capital market growth

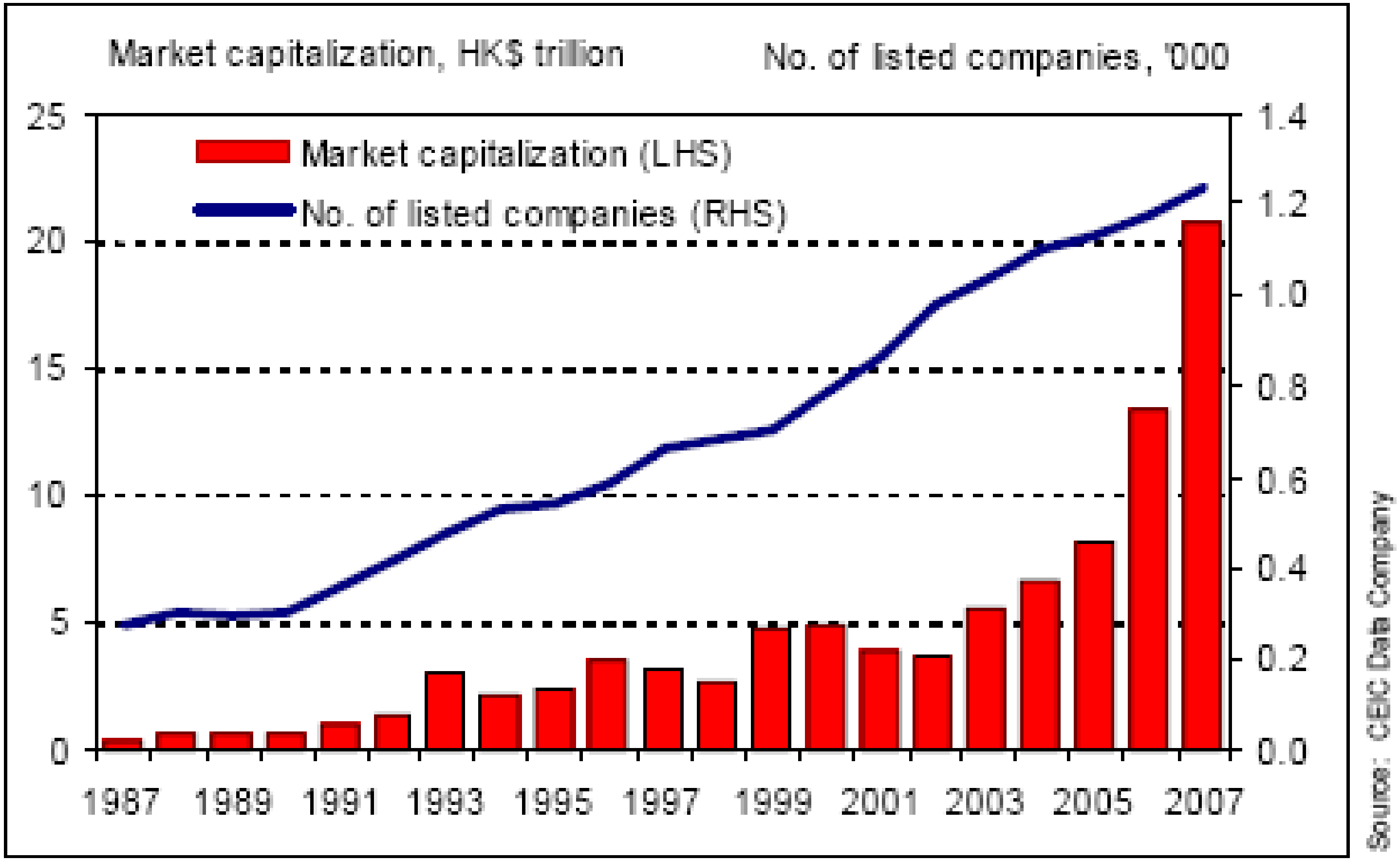

*Chart taken from Bauhinia Foundation report, 2008.

Board (under-performance) risk

- Are companies creating effective boards? Do directors know the difference between directing and managing?
  - **Board composition / size:** Does the board have the right mix of skills, given the strategic direction and needs of the company? Is it too large, too small, about right?
  - **Board committees:** Has sufficient thought been given to the choice of committees, how they operate and what they should achieve?
  - **Independent directors:** Have they been chosen well, with diverse skills and business expertise? Does the controlling shareholder allow them "voice"?
  - **Director knowledge:** Do directors have access to ongoing learning opportunities (about the company, regulation, etc)?
- VC/PE funds can add huge value to the development of effective boards in private companies. Please start early!

Organisational risk

- Are companies investing sufficiently in robust internal controls and creating a culture of accountability?
  - **Reporting lines:** Is the board properly supervising major areas of risk (eg, forex hedging contracts, large M&A transactions)? Does it prioritise risk?
  - **Accounting systems:** Preparation of accounts. Use of information technology. Decisions by senior management on accounting policy.
  - **Internal audit:** Who does it report to—the CFO or chair of the Audit Committee?
  - **External auditor:** Does the company allow its auditor to talk directly to the Audit Committee?

Shareholder-expectation risk

- Expectations and behaviour of institutional and retail shareholders is changing in the public-equity markets in Asia. Key issues:
  - **Proxy voting:** Investors need the earlier release of final AGM agendas if they are to vote in an informed way (28 days). They want their votes properly counted ("voting by poll") and the results published.
  - **"Pre-emption rights":** Large and dilutive private placements to a select group of investors increases risk to other shareholders.
  - **Privatisations/delistings:** Protection for minority shareholders (eg, approval processes) are weak in much of Asia. Better in Hong Kong.
  - **Related-party transactions:** Large transactions that benefit the controlling shareholder also increase investment risk and will devalue the company over time. For this reason, one notorious Hong Kong company recently had a PE of 0.53 and a PBR of 0.05.
- VC/PE funds can help private companies prepare for and understand this brave new world before they IPO. Give directors briefings. Create policies that meet these standards, rather than simply "following the rules".

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Stakeholder risk

- Stakeholder communities and issues are often fluid and also evolve in response to external factors:
  - Among investors, the understanding of “CSR” (corporate social responsibility) is changing and morphing into “ESG” (environmental, social, governance). ESG puts an explicit governance foundation under CSR.
  - Greater focus on the need for investors to incorporate environmental, social and governance **risks** into the investment process. For example:
    - United Nations Principles of Responsible Investment (UNPRI).
    - Greater attention on whether newly listed companies meet requisite environmental and labour standards.
    - Global pension funds looking for fund managers who can invest along ESG lines.
- Institutional investors in your IPO will be increasingly interested in your ESG performance.

4. Conclusion

- Corporate governance has improved in Asia, but quality varies between markets and companies.
- CG risk is a moving target. Directors and managers cannot afford to be arrogant or complacent.
- Directors are responsible for understanding risk and ensuring that managers mitigate it.
- VC/PE funds can add considerable value to a company by improving their governance before IPO.

Final thought

"We were serious about the board members we picked and now we are benefitting from it."

CFO,

PRC private company, US-listed.

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