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Asian Corporate Governance Association (ACGA)

“선진 각국의 사외이사 제도”
(The Outside Director System: Best Practices from Advanced Markets)

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법무부. 금융위 사외이사 제도의 개선방안 공동 세미나
2012.6.12

Introducing ACGA

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

- ACGA is incorporated in Hong Kong as a non-profit association, and is independently funded by a corporate membership base from Asia-Pacific, Europe and North America.

"Outside Directors" ≠ Independent Directors

- In Korea, the focus of board reform has been on strengthening the role of "**outside directors**".
- But in most advanced markets, the focus is on empowering genuinely **independent directors**.
- Terminology matters:
  - In Korea, many observers have questioned the independence of "outside directors".
  - So the current efforts to improve this situation are a step in the right direction.
- **Independent directors** are important because they can help:
  - Supervise management on behalf of all shareholders.
  - Provide an independent perspective on corporate strategy to help maximise long-term corporate value.
  - Manage corporate crises and mediate disputes among major shareholders.

Case Study 1 – Olympus Corp.

- Problem
  - In late 2011, Olympus admitted to a US$1.7 billion accounting fraud—led by its chairman—to cover up investment losses since the 1990s.
- Role of independent directors
  - Olympus had 3 "outside directors" out of a total of 15.
  - Obviously, the "outside directors" failed to see or stop the fraud.
  - But 2 of the 3 outgoing "outside directors" led the nomination of an entirely new board consisting of majority "outside directors" (6 out of 11)
- Outcome
  - At an EGM in April, shareholders approved the new board.
  - Will more "outside directors" lead to better supervision? That is what the shareholders are hoping, but it remains to be seen.
  - There have been many scandals at companies where independent directors were in the majority (Enron, Bear Stearns, Satyam, etc).
  - **The independent director system is only good as the quality of the independent directors—and the extent to which management allows them to have a voice.**

Case Study 2 – BP Plc.

- Problem
  - On April 20, 2010, an explosion on an offshore drilling platform in the Gulf of Mexico unleashed a massive underwater oil spill.
  - US government investigators blamed the disaster, which was not contained until mid-July, on BP's cost-cutting and inadequate safety measures.
- Role of independent directors
  - BP had 10 independent directors out of a total of 15 at the time.
  - BP had an independent chairman, who was not the CEO.
- Outcome
  - On July 27, 2010, the board fired CEO Tony Haywood, who had made a series of insensitive remarks that seemed to downplay the accident.
  - BP board met 25 times in 2010, and at least once a week during the crisis. All independent directors visited the Gulf of Mexico site.
  - In July 2010, BP also set up a special committee of independent directors to oversee the company's long-term response to the disaster, including legal, financial and reputational aspects.
  - **BP's reputation had been seriously damaged, but it might have been worse without the actions of the independent directors.**

Case Study 3 – Yahoo! Inc.

- Problem
  - In early May, an activist investor accused the new CEO, Scott Thompson, of lying on his resume about his university degree in computer science → in fact, Thompson was an accounting major.
- Role of independent directors
  - Yahoo! had 9 independent directors out of a total of 10 at the time.
  - Patti Hart, an independent director who headed the nomination committee, had been responsible for checking Thompson's background.
- Outcome
  - On May 12, Yahoo! fired Thompson as CEO.
  - A few days before, the other board members also pressured Hart not to seek re-election as a director at this year's AGM.
  - The board also set up a special committee comprising 3 independent directors to investigate the circumstances leading to the scandal.
  - **Yahoo!'s independent board has moved quickly to resolve the case and avoided a damaging proxy fight.**

Comparing Board Independence

- Korean rules don't look bad on paper.

	US	HK	Singapore	Japan	Korea
Independent or "outside directors" required on the board?	Majority	At least 3 *(One-third by end of 2012)*	At least 2 *(One-third to one-half under new CG Code)*	None *(But rules are slowly changing)*	Majority (for large listed firms)
Board committees run by independent or "outside directors" required? (for example, audit, nomination)	Yes	Yes	Yes	No	Yes (for large listed firms)

Definition of Independent Director

- Definitions of independent director should not focus too much on quantitative criteria, such as:
  - Cannot be an employee for the past 2, 5 or X years.
  - Cannot own more than X% of the company’s shares.
- Instead, a more robust definition would be qualitative and include core principles:
  - An independent director should be “independent of management and free from any business or other relationship that could materially interfere with the exercise of independent judgement”.
    — (Cadbury Report, UK)
- What matters most is having an ‘**independent mind**’ and a **willingness to speak** candidly.

한국 “기업지배구조 모범규준” (2003.2)

- “사외이사제도의 가장 중요한 목적은 이사회가경영감독 기능을 효과적으로 수행할 수 있도록하기 위한 것이다. 사외이사는 사내이사에비해경영진과 지배주주로부터 <u>**독립적인 위치**</u>에 있으므로 경영진을 효과적으로 감독하고경영진에게객관적인 조언을 제공할 수 있다.”
- “사외이사는 기업, 경영진과 지배주주로부터 <u>**독립적인 의사결정**</u>을 할 수 있는 자이어야한다.”

Qualifications of Independent Director

- Just as important as **who can be** independent directors is **what kind of person should be** independent directors.
- Independent directors need broad business and managerial experience if they are to contribute successfully to a company.
- Ideally, they should be businessmen who have already accomplished a lot in their careers.
- Too many academics and former bureaucrats should be discouraged.
- Globalised Korean companies can benefit from having foreign independent directors with different skills and geographic knowledge.

Foreign Independent Directors in China

Bruce Douglas Moore
(China Life Insurance)

Rt. Hon. Dame Jenny Shipley
(China Construction Bank)

Peter Bowie
(China Overseas Shipping)

Franco Bernabè
(PetroChina)

Recommendations for Korea

- Of course, tougher regulations can be a useful stick to force listed companies to change their ways quickly.
- But that can produce a compliance-oriented approach with superficial and cosmetic results.
- What matters more is reforming the ingrained corporate culture of Korean companies.
- One way that can be done is if shareholders became more involved and responsible (market-based solution):
  - Encourage domestic institutional investors to exercise their voting rights in an informed manner → for example, voting against underperforming directors at AGMs.
  - Consider incorporating some recommendations in the UK Stewardship Code* into securities law.

*Adopted by the UK in 2010, and sets CG guidelines for institutional investors, including on having a clear policy on voting and disclosure of voting activity.

ACGA

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