CORPORATE GOVERNANCE IN ASIA: AN EIGHT-COUNTRY COMPARATIVE STUDY

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Abstract

Corporate governance has received an increasing amount of attention in recent years. Corporate scandals have brought corporate governance weaknesses to the attention of the general public, especially in the United States. But corporate governance is sometimes a problem in other countries as well. This paper begins with an overview of some basic corporate governance principles as identified by the OECD, World Bank and IMF, then proceeds to examine how these principles are being applied in selected Asian countries.

Keywords: corporate governance, board of directors, Asia

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Introduction

Corporate governance has become an important topic in transition economies in recent years. Directors, owners and corporate managers have started to realize that there are benefits that can accrue from having a good corporate governance structure. Good corporate governance helps to increase share price and makes it easier to obtain capital. International investors are hesitant to lend money or buy shares in a corporation that does not subscribe to good corporate governance principles. Transparency, independent directors and a separate audit committee are especially important. Some international investors will not seriously consider investing in a company that does not have these things.

Several organizations have popped up in recent years to help adopt and implement good corporate governance principles. The Organisation for Economic Cooperation and Development, the World Bank, the International Finance Corporation, the U.S. Commerce and State Departments and numerous other organizations have been encouraging governments and firms in Eastern Europe to adopt and implement corporate codes of conduct and good corporate governance principles.

The Center for International Private Enterprise (2002) lists some of the main attributes of good corporate governance. These include:

- Reduction of risk
- Stimulation of performance
- Improved access to capital markets
- Enhancement of marketability of goods and services
- Improved leadership
- Demonstration of transparency and social accountability

This list is by no means exhaustive. However, it does summarize some of the most important benefits of good corporate governance. All countries, whether developed or developing face similar issues when it comes to corporate governance. However, transition economies face additional hurdles because their corporate boards lack the institutional memory and experience that boards in developed market economies have. They also have particular challenges that the more developed economies do not face to the same extent. Some of these extra challenges include:

- Establishing a rule-based (as opposed to a relationship-based) system of governance;
- Combating vested interests;
- Dismantling pyramid ownership structures that allow insiders to control and, at times, siphon off assets from publicly owned firms based on very little direct equity ownership and thus few consequences;
- Severing links such as cross shareholdings between banks and corporations;
- Establishing property rights systems that clearly and easily identify true owners even if the state is the owner; (When the state is an owner, it is important to indicate which state branch or department enjoys ownership and the accompanying rights and responsibilities.);
- De-politicizing decision-making and establishing firewalls between the government and management in corporatized companies where the state is a dominant or majority shareholder;
- Protecting and enforcing minority shareholders' rights;
- Preventing asset stripping after mass privatization;
- Finding active owners and skilled managers amid diffuse ownership structures; and
- Cultivating technical and professional know-how (CIPE 2002).

Review of the Literature

Hundreds of articles and dozens of books have been written about corporate governance in the last few years alone. One book that should be mentioned is *Corporate Governance* by Monks and Minow (2004). Davis Global Advisors publishes an annual *Leading Corporate Governance Indicators* (2007), which measures corporate governance compliance using a variety of indicators.

The Cadbury Report (1992) published the findings of the Committee on Financial Aspects of Corporate Governance. The Greenbury Report (1995) discusses directors' remuneration. The Hampel Committee Report (1998) addresses some of the same issues as the Cadbury and Greenbury reports. It has separate sections on the principles of corporate governance, the role of directors, directors' remuneration, the role of shareholders, accountability and audit and issued conclusions and recommendations. The *Encyclopedia of Corporate Governance* is a good reference tool for obtaining information on corporate governance. It is available online. The OECD's *Principles of Corporate Governance* (1999) has been used as a benchmark for a number of corporate governance codes in transition economies. OECD has also published a *Survey of Corporate Governance Developments in OECD Countries* (2003b). The European Corporate Governance Institute maintains many links to codes of corporate conduct for many countries on its website.

The OECD has also published several studies on corporate governance in Asia, the most notable being its *White Paper on Corporate Governance in Asia* (2003c). Clarke (2000) criticized corporate governance structures in Asia. His criticism focused on the Asian financial crisis, which was partially caused by poor corporate governance practices.

The Securities and Exchange Board of India (2002) issued the *Kumar Report* on corporate governance in India. This report attempted to evolve a code of corporate governance for Indian corporations. Mani (2004) did a country study of India for Standard & Poor's that looked at a number of factors, including market infrastructure, the legal environment, the regulatory environment and the informational infrastructure.

Solomon, Solomon and Park (2002a) developed a conceptual framework for corporate governance in Korea. They also examined some empirical evidence on the evolving role of institutional investors (2002b). Jang and Kim (2002) did a case study of Samsung Corporation's governance policies and procedures. Kim (2003) looked at the interlocking ownership of the Korean chaebols. Wong (2004) did a country governance study of Korea for Standard & Poor's that examined the same factors as those examined by Mani (2004) in the India study.

Several studies of various aspects of corporate governance have been done for China. Dahya, Karbhari, Xiao and Yang (2003) examined the usefulness of the supervisory board report. Chen (2004) takes a critical view of the corporate governance policies of China's state-owned enterprises. Tam (2000) also looks at state-owned enterprises and attempts to outline a new corporate governance model that is appropriate for China's economic and social conditions.

Guidelines

Numerous articles, documents and reports have been published in recent years that provide some policy guidelines for good corporate governance. Such documents are especially valuable for transition economies, since the subject of corporate governance is new for them and even their top government and private sector leaders have little or no experience governing market oriented private firms that have a public constituency. One of the better documents in this area was published by the Institute of International Finance. Its *Policies for Corporate Governance and Transparency in Emerging Markets* (2002) provides a set of guidelines that corporate officers and directors can use when establishing or revising their own company's corporate governance rules. Here are some of the main suggestions.

Minority Shareholder Protection

The company should have a formal policy that defines voter rights and which corporate actions require shareholder approval. There should also be a mechanism that allows minority shareholders to voice their objections to majority decisions. Minority shareholders should have the legal right to vote on all important matters, including mergers and the sale of substantial assets.

Firms should be encouraged to allow proxy voting and proxy systems should be available to all shareholders, foreign and domestic. Multiple voting classes should be eliminated where they exist. The number of nonvoting and super voting shares should be reduced or eliminated and all new issues should have a "one share, one vote" policy.

Cumulative voting should be permitted. Shareholder approval of takeovers, mergers and buyouts should be required. Any anti-takeover measures such as poison pills, golden parachutes and issuances of bonds with special rights in the event of a takeover should have to be approved by shareholders. Spin-offs should also require a majority vote of all shareholders.

Dilution of ownership or voting rights should require a majority vote of all shareholders, at the very least. The IIF recommends a supermajority vote as a "Best Practice." In the event of a takeover or delisting, all shareholders should be offered the same terms.

Shareholder approval should be required before a company can sell additional shares to existing majority shareholders after some threshold. Any capital increases should first be offered to any existing shareholders. Significant share buybacks should require shareholder approval.

Shareholders should be notified a sufficient time in advance of shareholder meetings. The "Best Practice" is to send a notice of the meeting and agenda at least one month prior to the meeting. Reasonable efforts should be taken to prevent vote fraud and to allow for a recount in the event an election is contested. Minority shareholders should be able to call special meetings and petition the board with some minimum share threshold.

Foreign and domestic shareholders should be treated equally. A policy should be established to clearly define who retains the right to vote when shares are traded close to the meeting date. Quorum rules should not be set too low or too high. The IIF recommends around 30 percent, which should include some independent minority shareholders.

Structure and Responsibilities of the Board

The company should define independence, disclose the biographies of board members and make a statement on independence. The IIF recommends that as a Best Practice a board member cannot (a) have been an employee of the firm in the past 3 years, (b) have a current business relationship with the firm, (c) be employed as an executive of another firm in which any of the company executives serve on that firm's compensation committee, and (d) be an immediate family member of an executive officer of the firm or any of its affiliates.

At least one-third of the board should be non-executive, a majority of whom should be independent. The Best Practice calls for a majority of independent directors. The board should meet every quarter for large companies. The audit committee should meet every six months. Minutes of meetings should become part of the public record. The Best Practice would be to apply this rule to all companies.

The quorum requirement should be specified by the firm and should consist of executive, nonexecutive and independent nonexecutive members. Best Practice calls for representation by both executive and independent directors.

Nominations to the board should be made by a committee that is chaired by an independent nonexecutive. There should be a mechanism in place that would allow minority shareholders to put forth the names of potential directors at annual general meetings and extraordinary general meetings.

For large firms, directors should need to be re-elected every three years. The Best Practice rule would apply the three-year requirement to firms of any size. For large companies, the compensation and nomination committees should be chaired by an independent nonexecutive director. The Best Practice would be to extend this requirement to firms of any size.

The board should formally evaluate directors before their election, in the case of large firms. The Best Practice is to extend this requirement to firms of any size.

The board should disclose immediately any information that affect the share price, including major asset sales or pledges. Procedures should be established for releasing information. Best Practice calls for releasing information on the company website at through the stock exchange.

Remuneration for all directors and senior executives should be disclosed in the annual report. All major stock option plans should be disclosed and subjected to shareholder approval. The company's articles of association or bylaws should clearly state the responsibilities of directors and managers. This document should be accessible to all shareholders. The chairman or CEO should publish a statement of corporate strategy in the annual report.

Any actual or potential conflict of interest involving a board member or senior executive should be disclosed. Board members should abstain from voting in cases where they have a conflict of interest. The audit or ethics committee is required to review conflict of interest situations.

The integrity of the internal control and risk management system should be a function of the audit committee, according to the Best Practice guideline. The company should have an investor relations program. Best Practice requires the CFO or CEO to assume this responsibility as part of the job. The company should make a policy statement concerning environmental and social responsibility issues.

Accounting and Auditing

The company should disclose which accounting principles it is using. It should comply with local practice and file consolidated annual statements where appropriate. Companies should file annual audited reports and semi-annual unaudited reports. Best Practice calls for filing quarterly unaudited reports.

Audits should be conducted by an independent public accountant. Best Practice calls for adherence to the standards developed by the International Forum on Accountancy Development. Off balance sheet transactions (e.g. operating leases and contingent liabilities) should be disclosed.

The audit committee should issue a statement on risk factors. For large companies, the audit committee should be chaired by an independent director. Best Practice calls for the audit committee chair to be an independent director regardless of company size. The chair must have a financial background. A minimum of one week should be allocated for any committee review of an audit. Communication between the internal and external auditor should be without having executives present. Any departures from accounting standards must be explained in the annual report.

Transparency of Ownership and Control

Best Practice calls for significant ownership (20-50%, including cross-holdings) to be deemed as control. For buyout offers to minority shareholders, Best Practice calls for ownership exceeding 35% to be considered as triggering a buyout offer in which all shareholders are treated equally.

Companies should disclose directors' and senior executives' shareholdings and all insider dealings by directors and senior executives should be disclosed within 3 days of execution. Best Practice calls for shareholders with minimally significant ownership (3-10%) of outstanding shared to disclose their holdings. There should be independence between industry and government. There should be rules outlining acceptable employee and management conduct.

This Institute of International Finance document is not the only comprehensive set of guidelines on corporate governance practices. The Organization for Economic Cooperation and Development (OECD) (1999; 2002; 2003a&b) has several comprehensive documents as well. Private groups have also issued comprehensive guidance documents. Gregory (2000) has published a major study that compares various sets of guidelines.

Merely having rules and guidelines is not enough to ensure success, however. Culture, institutions and organizational structure also play an important role. Roth and Kostova (2003) conducted a major study of 1,723 firms in 22 countries in Central and Eastern Europe and the Newly Independent States and found that a firm's adopting a new governance structure will be helped or hindered based on these factors.

Asian Case Studies

The World Bank (2003; 2004a & b; 2005a, b & c; 2006a & b) has conducted a number of studies of corporate governance practices in various countries all over the world. It has conducted eight studies of Asian countries. This part of the paper summarizes some of the components of those studies. Noticeably absent are China and Japan. It classified the extent of the observance of various corporate governance practices into five categories. The following tables show the classification for each of the eight Asian countries in ten categories. The categories are as follows:
O = Observed
LO = Largely Observed
PO = Partially Observed
MNO = Materially Not Observed
NO = Not Observed

Basic Shareholder Rights

Table 1 shows the scores for the category Basic Shareholder Rights. India was the only country earning the highest score. Five countries largely observed basic shareholder rights. Indonesia and Vietnam only partly observed basic shareholder rights.

Table 1. Basic Shareholder Rights

	O	LO	PO	MNO	NO
India	x				
Indonesia			x		
Korea		x			
Malaysia		x			
Pakistan		x			
Philippines		x			
Thailand		x			
Vietnam			x		

Participation Rights

Table 2 shows how the countries scores in the area of participation rights. This time both India and Korea had the top ratings. Indonesia, Pakistan and the Philippines largely observe participation rights, whereas Malaysia, Thailand and Vietnam only partly observe these rights.

Table 2. Participation Rights

	O	LO	PO	MNO	NO
India	x				
Indonesia		x			
Korea	x				
Malaysia			x		
Pakistan		x			
Philippines		x			
Thailand			x		
Vietnam			x		

Market for Corporate Control

In the area of the market for corporate control the only country that got the highest rating was India. Table 3 shows the relative ratings. Five of the eight countries did poorly in this category, although none of them earned the lowest possible rating.

Table 3. Market for Corporate Control

	O	LO	PO	MNO	NO
India	x				
Indonesia				x	
Korea		x			
Malaysia		x			
Pakistan			x		
Philippines			x		
Thailand			x		
Vietnam				x	

Equal Treatment of Shareholders

None of the countries earned the top rating for equal treatment of shareholders, as can be seen in Table 4. Korea and Pakistan had the next highest rating. Vietnam had the lowest, with a rating of materially not observed.

Table 4. Equal Treatment of Shareholders

	O	LO	PO	MNO	NO
India			x		
Indonesia			x		

Korea		x			
Malaysia			x		
Pakistan		x			
Philippines			x		
Thailand			x		
Vietnam				x	

Disclosure of Interests

None of the countries had the top rating in the category of disclosure of interests. Malaysia, Pakistan and Thailand had the next highest rating; Vietnam had the lowest rating. Table 5 shows the ratings.

Table 5. Disclosure of Interests

	O	LO	PO	MNO	NO
India			x		
Indonesia			x		
Korea			x		
Malaysia		x			
Pakistan		x			
Philippines			x		
Thailand		x			
Vietnam				x	

Access to Information

India and Korea give their shareholders the best access to information. Indonesia, the Philippines and Vietnam give their shareholders the least access, although none of these countries earned the lowest or second lowest rating in this category. Table 6 shows the ratings.

Table 6. Access to Information

	O	LO	PO	MNO	NO
India	x				
Indonesia			x		
Korea	x				
Malaysia		x			
Pakistan		x			
Philippines			x		

Thailand		x			
Vietnam			x		

Disclosure Standards

Disclosure standards were not particularly good for any of the countries. None of them earned the top rating. Vietnam had the lowest rating in this category. Table 7 shows the results.

Table 7. Disclosure Standards

	O	LO	PO	MNO	NO
India		x			
Indonesia			x		
Korea		x			
Malaysia		x			
Pakistan		x			
Philippines			x		
Thailand		x			
Vietnam				x	

Accounting & Audit Standards

Table 8 shows the ratings for accounting and audit standards. Malaysia was the only country that had the top rating. There is a lot of room for improvement in this category. Half of the countries only partly observed these standards.

Table 8. Accounting and Audit Standards

	O	LO	PO	MNO	NO
India		x			
Indonesia			x		
Korea			x		
Malaysia	x				
Pakistan		x			
Philippines		x			
Thailand			x		
Vietnam			x		

Independent Audits

As Table 9 shows, none of the countries observed the guideline for independent audits, although half of them largely observed it.

Table 9. Independent Audits

	O	LO	PO	MNO	NO
India			x		
Indonesia			x		
Korea		x			
Malaysia		x			
Pakistan		x			
Philippines			x		
Thailand		x			
Vietnam			x		

Fair & Timely Dissemination

India and Korea were the only countries that observed the guideline for fair and timely dissemination of information. Vietnam scored the lowest in this category. Table 10 shows the results.

Table 10. Fair and Timely Dissemination

	O	LO	PO	MNO	NO
India	x				
Indonesia			x		
Korea	x				
Malaysia		x			
Pakistan		x			
Philippines			x		
Thailand		x			
Vietnam				x	

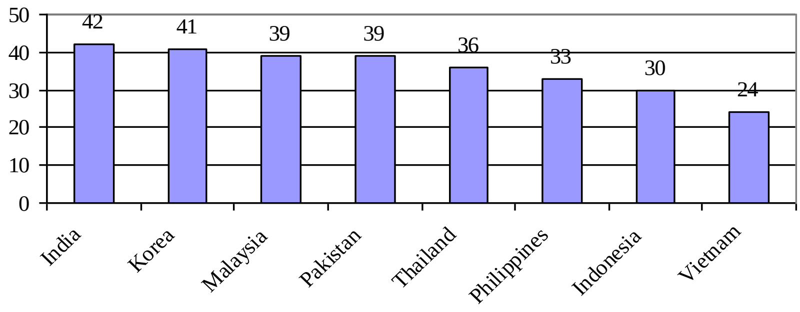
Country Comparisons

The above tables rated the eight Asian countries in 10 categories. The next step is to assign point values to each of those categories, as follows:

O = Observed [5 points]
LO = Largely Observed [4 points]
PO = Partially Observed [3 points]
MNO = Materially Not Observed 2 points]
NO = Not Observed [1 point]

If a country earned the highest score for each of the ten categories, it's corporate governance score would be 50 [10 x 5]. The lowest possible score would be 10 [10 x 1]. Chart 1 shows the scores for each of the eight Asian countries.

Chart 1
CG Scores (50 is best)



None of the countries had a perfect score of 50. India came closest with a score of 42, followed closely by Korea. Next are Malaysia and Pakistan, which tied for third place. Thailand was in fifth place, followed by the Philippines, Indonesia and Vietnam, which had the lowest score at 24.

Concluding Comments

None of the countries earned a perfect score of 50, which means they all have some work to do to meet the corporate governance guidelines. But some countries have more work to do than others. Vietnam can be excused for having such a low score. It is a relatively new entrant to the market and has not been trying to attract foreign investment from the private sector as long as have some of the other Asian countries. The private sector in Vietnam is still in the fledgling stage and will probably continue at this level of development for some time, although the country has a relatively high growth rate. But it is starting from such a low level of economic activity that it has a way to go before becoming competitive in international capital markets.

The relatively high scores of India and Korea do not come as a surprise. Although India is noted for bureaucracy and corruption, its corporations are making progress in the area of corporate governance. Korea is one of the Asian tigers. It has ready access to capital, partly because of its relatively good corporate governance practices but also because of the structure of the Korean economy. The good old boy network is still alive and well there.

The scores for each of these countries will likely improve with time. There is internal pressure to improve corporate governance as well as external pressure. The market provides incentives to improve and to compete in practically every area of economic activity, including the realm of corporate governance. Those who do not clean up their act will be left behind as corporations in other countries improve their corporate governance practices.

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