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Progress, Unfinished Business, and the Rewards of Corporate Governance Reform in Asia

Jamie Allen

1. Introduction

Considerable progress has been made in corporate governance reform in the Asian region since the regional financial crisis of 1997–98. Tangible improvements can be seen in many countries in areas such as corporate reporting, board composition and effectiveness, shareholder rights, accounting and auditing standards (and practices), and regulatory enforcement of securities laws and listing rules. The quality of corporate governance does vary markedly between, and within, countries, yet almost all have moved forward.

Looking ahead, what are the major areas of unfinished business in corporate governance reform? What further regulatory reform is required? To what extent are shareholders—both institutional and retail—exercising their rights, and what challenges do they face in doing so? Why have so few listed companies in each market built a strong reputation for good governance (with the winners of corporate governance awards often being the "usual suspects")? Is the government showing leadership to the corporate sector by fighting internal corruption and public sector mismanagement?

This paper will argue that these issues need to be addressed in order to reduce investment risks and to raise the quality of capital markets around

the region. Although the consequences of doing nothing may be hard to discern over the short term—especially during market booms—failure to act on the part of governments, regulators, companies, investors, and intermediaries will be counterproductive over the longer term. The more successful markets are those that balance the interests of the supply side (issuers, investment banks, and other intermediaries) with the interests of the buy side (investors, and broader society in general). Despite emotional warnings that over-regulation would kill markets, the history of the past decade or more in Asia has been one of steadily increasing regulation in corporate governance and expanding capital markets. The one exception (Japan) is also the market with the most ambivalent policies on corporate governance.

The rest of the paper is organised in two parts. The first briefly documents the progress made in the Asian region on the corporate governance front, while the second identifies the key themes where more work remains to be done.

2. Progress in Asian corporate governance: 1998–2010

As would be expected given the differing levels of industrialisation, capital market development, and government transparency/corruption around Asia, the quality of corporate governance varies considerably between markets. Table 1 provides a macro assessment of the state of corporate governance in 11 Asian markets in 2007.

Table 1: Market rankings of corporate governance quality in 11 Asian markets

Rank	Market	Rules & Practices (%)	Enforce (%)	Political & Regulatory (%)	IGAAP (%)	Culture (%)	Total Score (%)	2005 (%)
1	HK	60	56	73	83	61	67	69
2	Singapore	70	50	65	88	53	65	70
3	India	59	38	58	75	50	56	61
4	Taiwan	49	47	60	70	46	54	52
5	Japan	43	46	52	72	49	52	–
6	Korea	45	39	48	68	43	49	50
7	Malaysia	44	35	56	78	33	49	56
8	Thailand	58	36	31	70	39	47	50
9	China	43	33	52	73	25	45	44
10	Philippines	39	19	38	75	36	41	46
11	Indonesia	39	22	35	65	25	37	37

Source: ACGA & CLSA Asia-Pacific Markets, 2007.

The total scores fell between 2005 and 2007 in most markets not because the quality of corporate governance declined, but because the survey methodology became somewhat tougher.[1]

Despite the different rates of progress between markets, it is possible to assert that all jurisdictions in Asia have witnessed some degree of tangible improvement in governance standards and practices since the late 1990s. Much of the focus of early reforms was on enhancing corporate accountability to shareholders by introducing an independent element (in the form of independent directors) into company boards, and encouraging them to function more effectively through the adoption of board committees, especially for audit. Table 2 and Table 3 show the extent of change from 1997 to 2008.

Table 2: The state of corporate governance in Asia in 1997

Country/ market	Was there an official code of best practice?	Did the idea of "independent director" exist?	Did the idea of audit committee exist?
China			
Hong Kong	Yes (but very short)	Yes	Yes
India			
Indonesia			
Japan			
Korea			
Malaysia		Yes	Yes
Philippines			
Singapore		Yes	Yes
Taiwan			
Thailand			

Source: Asian Corporate Governance Association.

Table 3: Corporate governance in Asia in 2008

Country	Date of main codes	Are independent directors required?	Are audit committees required?
China	2002/2005	Yes	Yes
Hong Kong	1993/2004	Yes	Yes
India	1999/2005/2007	Yes	Yes
Indonesia	2001/2006	Yes	Yes
Japan	(2003)/2004	Optional	Optional
Korea	1999/2003	Yes	Yes (large firms)
Malaysia	2001	Yes	Yes
Philippines	2002	Yes	Yes
Singapore	2001/2005	Yes	Yes
Taiwan	2002	Yes (certain firms)	Yes (certain firms)
Thailand	1999/2006	Yes	Yes

Source: Asian Corporate Governance Association.

The nature and history of the legal regime of governments (i.e. common law derived from Britain vs. civil law derived from Continental

Europe) is not the determining factor in whether governments require listed companies to appoint independent directors; it is an internal policy decision in response to the demands of the international capital markets. Both China and India mandate independent directors, yet have quite different legal systems and company law. Company law in China is closer to that in Japan and Taiwan, yet all three places take quite different approaches to independent directors and audit committees. Whereas Beijing made a conscious policy decision in the early 2000s to move towards global norms on these aspects of modern board governance, Taiwan has gone only halfway (only certain listed companies are required to adopt these standards), and Tokyo resisted all demands for a single standard on board independence until very recently (and even then did not fully commit itself).[2]

Other early reforms around Asia brought about improvements in the frequency and speed of financial reporting (i.e. quarterly reports, and shorter deadlines for annual and interim reports), the amount of detail required in financial reports, and brought in requirements for more disclosure on director share dealings. All jurisdictions in Asia now require some form of quarterly reporting for their main board listed companies, with the exception of Hong Kong.

Significant changes have also been seen in accounting policies and standards, auditing standards, and the regulation of the audit profession. All Asian markets have already adopted or are moving towards full (or almost full) adoption of international accounting standards. Hong Kong and Singapore are leading in this process, with other markets at varying stages of convergence. The most dramatic change occurred in 2006, when China announced that it would move immediately towards adopting IFRS. As for auditing, CPA industry bodies in all major Asian markets are members of the International Federation of Accountants (IFAC), based in New York, and follow its international standards on auditing.[3]

Differences remain however, in the regulation of the audit profession. Some Asian governments have followed the lead of the US, the UK, and the European countries in setting up independent statutory bodies to

supervise the work of CPA firms, and to sanction them for transgressions. This is reflected in the fact that several Asian jurisdictions are members of the International Forum of Independent Audit Regulators (IFIAR)[4], including Japan, Korea, Singapore, Sri Lanka and Taiwan. IFIAR was formed in 2003 with membership open only to audit regulators that are truly independent of the profession they regulate. It is understood that China is seeking to join IFIAR, while Hong Kong and India are not eligible to become members because their primary audit regulator—the local CPA industry body in both cases—is not independent of the profession.

Non-regulatory dimensions

Although governments and financial regulators (including stock exchanges) have been the main drivers of corporate governance reform in Asia over the past decade, other groups have played catalytic roles as well. They include (in rough chronological order of appearance on the reform scene) retail shareholders, professional associations (like institutes of directors), non-profit organisations, and institutional shareholders,

Far less constrained and conflicted than institutional investors, retail shareholders in several Asian markets became active proponents of better corporate governance soon after the financial crisis of the late 1990s. They included maverick individuals and organisations such as David Webb in Hong Kong, Professor Hasung Jang and his PSPD-PEC group in Korea (now known as Solidarity for Economic Reform)[5] , and David Gerald and the Securities Investors Association (Singapore) (SIAS) in Singapore. A little later new retail shareholder groups were also formed in Malaysia and Thailand (with support from the government in both instances, as was the case in Singapore). India also boasts a number of retail shareholder groups, the main difference from the rest of Asia being that these are largely city- or state-based, rather than national.

An early development in the professional sector was the creation of new institutes of directors (IODs) and formal director training courses. Hong Kong reconstituted and rejuvenated its IOD after China regained sovereignty in 1997, while Indonesia, the Philippines, Singapore and

Thailand all formed institutes around 1999–2000 (with help from the Australian Institute of Corporate Directors in the case of Thailand). Company secretarial associations have also been active promoters of corporate governance education, especially in Hong Kong, India, Malaysia and Singapore, while collaborative links are growing between some of these organisations—for instance the Hong Kong Institute of Chartered Secretaries has a representative office in Beijing and works closely with its counterparts in China.

Asia is also home to a range of civil society and/or independent non-profit organisations working in this field. The Japan Corporate Governance Forum (JCGF) published one of Asia's first best-practice guidelines in 1998. The Asian Corporate Governance Association (ACGA) was incorporated in Hong Kong in 1999, initially to undertake research and educational work in corporate governance across the region; more recently it has taken on an advocacy role as well. The Forum for Corporate Governance in Indonesia (FCGI) was formed in early 2000, followed a few months later by the Indonesian Institute for Corporate Governance (IICG). In 2002 the Taiwan Corporate Governance Association (TCGA) was established, and in 2004 the National Foundation for Corporate Governance (NFCG) began operations in India. Unlike the former organisations, however, both TCGA and NFCG were created with an element of government support.

With some notable exceptions (such as Mark Mobius of Templeton Asset Management), institutional investors came later to the party than other non-official groups due to several inhibiting factors such as a historic lack of involvement in basic governance activities like voting, and the lack of internal resources to support such time-consuming exercises; a strong belief among many that they should not intervene in management (the "vote with your feet" mentality); conflicts of interest within financial institutions that placed the interests of the company's investment and corporate banking arms above those of its mutual fund or investment management divisions; and a willingness to free ride on the activities of the few investors who were promoting corporate governance. Investors would also use the excuse that the voting of shares was pointless given

the concentrated ownership structures of most Asian listed companies and their family- or state-owned pedigree (i.e. they could not win a vote, so why bother?).

From 2003–2005 onwards the situation began to change. Some global investors started voting their shares in larger numbers. Many had been voting for years in Japan, where they had their biggest holdings in dollar terms, and they extended this to other parts of Asia such as Hong Kong, Korea, Singapore, Taiwan and Thailand. They began investing in creating dedicated corporate governance teams to manage their voting, and this in turn led to engagement with companies. They also devoted more time and resources to visiting the region in person. Meanwhile, among domestic institutions, certain state pension and investment funds—notably the Thai Government Pension Fund and the Employees Provident Fund of Malaysia—started to signal an interest in corporate governance.

These trends have intensified over the past five years. While hard data is not available, the volume of voting has clearly increased around Asia, as has the level of resources being invested in this activity.[6] The willingness of global investors to spend time in the region engaging with companies, joining fact-finding delegations, or meeting with regulators has also undergone a transformation.[7] And domestic investment managers in different countries, especially China, Japan, Korea and Thailand, are also voting in greater numbers (in part because in some counties, such as Korea and Thailand, they are required to by regulation).

A relevant question is to what extent investors and other non-official actors have positively shaped corporate governance regulation in Asia over the past 12–13 years (as opposed to limiting themselves to more general roles such as education and raising awareness). And to what extent have investors directly shaped company behaviour?

There is little evidence to suggest that investors and civil society groups had much impact on regulation in most countries during the first five years after the Asian financial crisis (1998–2002).[8] This was a period when governments and financial regulators either were under pressure

from international organisations such as the IMF, and/or were competing to prove their international credentials by adopting global standards of corporate governance. It was also a time when the influence of non-official organisations was limited by their own lack of experience, capacity, and following.

During the next five years (2003–2007), a different picture started to emerge. Retail investors and others interacted more with regulators, sought to influence the shape of regulation, and tried to encourage regulators to take their enforcement role more seriously. Although successful to some degree, these changes need to be seen in context. In most public consultation exercises, the voices of the more conservative local business leaders and listed companies (supported by their financial and professional advisors) tended to drown out the voices of other stakeholders, especially minority shareholders. Participation of institutional investors in regulatory consultations remained woefully low, while traditional investment industry associations (such as mutual fund bodies) made a conscious decision to remain quiet again due to the conflict of interest problem—many mutual fund managers are owned by big banks that do not wish to offend their major clients by publicly supporting stricter corporate governance norms. The contribution of some professional bodies (directors, company secretaries) was not always constructive. Although ostensibly formed to promote higher standards of corporate governance, some groups took a conservative and often negative view on certain new reforms (e.g. quarterly reporting, tighter rules on private placements and share pledges, according more power to the regulator).

The unsatisfactory aspect of this was that governments and financial regulators tended to be unduly influenced by those who “shouted loudest” (i.e. vested business interests) and those who were “standing nearest” (i.e. local interests). Few of them seemed to have a clear and consistent philosophy of regulation that guided how they dealt with different situations and balanced competing views. Too often compromises were made for short-term, political reasons.

While this dynamic remains real in Asia, the past two to three years (2008–2010) have brought certain new and more productive developments.

As a result of advocacy work carried out by institutional investors and some non-profit organisations (including ACGA) the rules governing some aspects of shareholder rights have been amended. One key area relates to voting at shareholder meetings—a fundamental right of shareholders, and an important way for them to engage with company management. Obstacles to efficient and transparent voting in Asia (as in many parts of the world) are rife; yet investor pressure has brought positive changes to rules on vote counting in Hong Kong, the earlier release of final meeting circulars in many markets, more translation of meeting materials and the de-clustering of meeting dates in Japan and Taiwan, and the publication of voting results in Japan.

Not all improvements have occurred as a result of rule changes. Market pressure has also managed to persuade companies to take voluntary steps to improve the transparency of their meetings. Companies in Hong Kong began voting by poll[9] several years before it became mandatory in 2009, while leading companies in Singapore and Taiwan are just starting to vote by poll. Top companies in China and Thailand also routinely vote by poll, though more as a result of encouragement from regulators than investors.

Indeed in certain respects, the ability of investors to inspire voluntary action on the part of companies is greater than their ability to achieve regulatory change. The answer to the earlier question regarding the extent to which investors have directly shaped company behaviour is that investors have probably had a greater impact than is generally appreciated. There are direct examples: companies voluntarily limiting the size of private placement mandates in Hong Kong and Singapore because they know that their shareholders do not like excessive dilution. They know this because shareholders vote against these mandates at every AGM, and while companies rarely lose the vote, the number of “against” votes is high enough to attract the attention of the management (which is a fitting rejoinder to those institutional investors who claim there is no value in voting). There are also indirect examples of investor influence: companies voluntarily improving the quality of their financial reports in order to communicate more effectively with shareholders.

Not surprisingly, these arguments need to be qualified. Companies in Asia that respond well to investor pressure on corporate governance tend to be the type of enlightened and better managed blue-chip firm with a large foreign ownership base that would be expected to respond well. Such firms account for a small percentage of all listed companies in any market. In other words, investors have yet to have a significant impact on the vast majority of smaller, less well-managed, and more parochial issuers.

A second caveat is that investors are not a uniform and homogeneous group. Not only does the industry divide into mainstream and alternative asset managers, short vs. long/short vs. long funds, value vs. growth funds, short-term vs. longer term investors, and so on, but the views of investors on the value of corporate governance to their investment process also differ widely, as does their willingness to spend money trying to engage with companies. At any point in time, the management of a listed company (especially one with a large following) is likely to face diverse and conflicting signals from the market. Investors who truly care about corporate governance make up a minority by number in this mélange (in the view of ACGA). Their challenge is to encourage management teams to listen to their constructive comments about governance and ignore the cynical silence from most of the industry.

3. Unfinished business

As the discussion above indicates, there are numerous areas where Asian corporate governance reform remains incomplete. This section touches upon some of the major areas where further work is necessary in most markets.

Corporate reporting

While it is not true that the governance standards in the more developed Asian markets are behind those in developed Western markets in every respect, one noticeable area of weakness in the region is the quality of continuous disclosure—the prompt disclosure of material price-sensitive information. All regulators in Asia have enacted rules requiring

listed companies to disclose news that could have a material impact on share prices, yet it would be fair to say that no market has yet created a robust culture of such disclosure (although there are exceptions at the company level).

Continuous disclosure became a bigger issue when stock prices collapsed over 2007–2008, and investors suddenly discovered that companies had problems they did not know existed. A good case in point was the huge money-losing derivative contracts that several listed PRC (People's Republic of China) firms in Hong Kong had entered into with investment banks before the global financial crisis. The issue also becomes a point of discussion every time a company scandal occurs and investors ask why they were not forewarned. Recent problems in Singapore regarding the failing businesses of some S-chips (locally listed PRC firms) caused anger among investors and embarrassed regulators.

The frequency of governance failures in many markets gives the lie to the idea that disclosure alone can be sufficient protection for investors (a concept strongly promoted by many regulators during the past decade). Firstly, the quality of disclosure has yet to reach the stage in any market where investors have a full and true picture of most listed companies. Secondly, a genuine disclosure-based regime needs to be matched by the robust enforcement of listing rules, company law, and securities laws—something that no Asian market is close to achieving.

Other aspects of corporate disclosure that need work include the speed of reporting (some markets have long deadlines for releasing interim and annual results), the quality of financial reports (even among blue-chips, the quality of reports can vary)[10] , and the quality of non-financial disclosure.

In essence, the challenge for governments, regulators, investors and enlightened companies in Asia is to create a culture where transparency is seen by businesses as a strength, not a weakness. While data on the governance quality of companies is somewhat limited in the region, recent surveys all tend to point in the same direction—that the market does recognise and reward (at least over the medium to long term) companies that are seen to be more transparent and better governed.

One of the few stockbrokers in the region to regularly track corporate governance is CLSA Asia-Pacific Markets.[11] Data from CLSA's company analysis in recent years indicates a link between high corporate governance scores, higher return on equity (ROE), and higher price-to-book (PB) ratios. In CLSA's sample of 536 listed Asian firms, the average ROE for the fiscal year 2009 was 18%, and the average PB ratio was 2.8 times. However companies that scored 75% or above in CLSA's corporate governance survey had an average ROE of 23%, and traded at an average PB of 3.9 times.[12]

A recent study of 692 listed companies in 10 Asian markets by UBS (the Swiss investment bank) found that the share prices of companies with better governance tended to outperform those with worse governance (UBS, 2009). As Table 4 shows, the average returns of a portfolio of stocks ranked highly on corporate governance criteria clearly outperformed those ranked poorly over one, two, and three years in four different markets (the one exception being Hong Kong over one year).[13] Not surprisingly, better governed companies tend not to outperform significantly over the short term (three to six months), except in Taiwan (UBS, 2009).

Table 4: Corporate governance portfolio returns

	3 months	6 months	1 year	2 years	3 years
Hong Kong	–5.4%	–3.0%	–0.4%	3.2%	9.6%
Singapore	–0.9%	3.3%	6.3%	6.1%	5.0%
Korea	–0.3%	1.2%	4.9%	4.3%	
Taiwan	7.5%	11.0%	9.1%	7.9%	

Source: UBS estimates based on data from Governance Metrics International (UBS, 2009).

One qualification needs to be made about the UBS results—while the bank found a link between good governance and share-price performance, unlike CLSA it was not able to establish a link between governance and valuation (UBS, 2009, p.7).

This result is slightly surprising, since many investors believe good governance does indeed lead to higher valuations and lower costs of

capital over the medium to long term, all else being equal in terms of management quality and business performance. And there is anecdotal evidence suggesting that companies with a track record of governance improvements and a prospectus that can be trusted will receive a higher valuation upon IPO. Unfortunately, no detailed study has been done yet on IPO valuations and corporate governance, most likely because it is extremely difficult since valuations are also affected by numerous factors external to any company.

For the sake of completeness, it should also be pointed out that CLSA's analysis of corporate governance in Asia over the past decade has shown that better governed companies tend to outperform in terms of share price during market downturns and periods of economic fragility, when there is a flight to quality, while lower ranked companies tend to do better during booming markets when the appetite of investors for riskier stocks increases. However this general pattern does not (in our view) negate the argument that transparency and accountability are fundamentally good for both capital markets and companies. Any government serious about developing its financial markets must take a long-term view, as must any company which wants to build a trusted brand, and gain strong support from investors and creditors.

Accounting and auditing

A second area of unfinished business—and one closely linked to the quality of corporate disclosure—is the issue of account preparation and audit quality. This is not simply an issue of accounting and auditing standards. As noted earlier, all jurisdictions have converged with international standards set down in the IFRS and International Standards of Auditing (ISA) rule books, or are in the process of doing so (albeit in slightly different ways, and with some exceptions). This is more an issue of how well companies prepare their accounts for audit, and how good a job the auditor does. Even if all Asian markets fully complied with international standards, the problems of preparation and auditing would remain.

A common complaint of the larger auditors around the region is that some of their clients provide incomplete annual or interim accounts for

them to audit. This necessitates a lot of back and forth correspondence after the period end to fill in blanks, and to allow the audit to be completed. PRC companies listed in Hong Kong are often cited in this context, although poor account preparation is clearly an issue in other markets as well. The factors contributing to this problem include a shortage of qualified accountants, under-utilisation of specialised accounting software in account preparation, and inconsistent application of accounting policies by senior management; in addition, accounting is seen as a low-level function within companies.

It seems clear that the inconsistent application of accounting policies in some companies is deliberate—a conclusion that many investors would agree with. Investors point to cases where companies will change their accounting policies (e.g. the recognition of debt or the valuation of assets) from quarter to quarter or from quarter to year-end, in order to manipulate their results in a positive light. While investors can highlight these problems and stay away from investing in companies they do not trust, what is needed in each market is a regulator that has the power to review company accounts and take action if necessary. One regulator that does have such powers is the Securities and Exchange Commission of Thailand.

While auditors may be frustrated with their clients, many investors are frustrated with auditors and the integrity of their audits. The Satyam scandal brought to light some shocking facts about the way in which auditors accepted the bank certificates that were provided by the company, rather than independently verifying this data with the banks themselves (as is required by standard auditing practices). Across the region audit quality has been shown to suffer from a range of pressures and conflicts, including fragmentation within the audit profession (i.e. far too numerous small and under-resourced audit firms in many Asian markets, especially India and Malaysia, theoretically licensed to audit corporate accounts); over-concentration of audits among the large global auditors—demand pressures on the Big 4 + 2[14] is so strong that their staff is stretched, especially during booming markets, and when there are uniform accounting

periods such as in India where most companies close their accounts on 31 March to coincide with tax audit requirements; lack of consistency in audit quality and peer reviews across the national partnerships that make up the global audit networks; and the need to sign off quickly on the accounts of companies applying to do an initial public offering, or simply the pressure of working on numerous IPOs simultaneously.

Following the enactment of the Sarbanes-Oxley Act in the US in 2002, Asian regulators have sought to minimise conflicts within the audit profession by introducing new rules on the mandatory rotation of audit partners, restrictions on non-audit work that auditors may undertake, disclosure of audit and non-audit fees in annual reports, disclosure of qualified audits, and so on. While these efforts appear to have brought about improvements in audit quality and a somewhat more independent audit profession, it seems clear they are not sufficient—not least because booming markets always engender problems, but because auditors are paid by the management teams they are assessing even though in some jurisdictions like India, audit appointments and remuneration are subject to the approval of shareholders in a general meeting.

A complementary (and probably more effective) solution would be the creation of an independent audit regulator that is not controlled or unduly influenced by the profession, and is tasked with carrying out investigations of audit cases and processes, and has the power to apply sanctions on firms and individuals. The role of audit within capital markets is far too important to be left to the vagaries of a conflicted industry body for regulation, or to audit firms for self-regulation.

Board effectiveness

Of all the ideas put forward regarding ways to improve company governance and accountability, none receives as much attention as the notion of board independence. Yet after a decade of board reform, the broad perception is that independent directors and board committees have had only a superficial impact (if at all) on most listed companies. The major faux pas at India's Satyam Computers in 2008–2009 only served to further strengthen this view.

To some degree this is the fault of governments who too quickly brought in mandatory requirements for independent directors and audit committees without (1) spending time persuading companies why these reforms were worth doing and how they would benefit them; (2) ensuring that proper systems of director training were in place for both IPO candidates and existing listed companies; (3) ensuring that the definitions of independent director in their listing rules were truly robust, principles-based, and meaningful, as opposed to artificial, prescriptive, and easily circumvented; and (4) thinking about how to create systems of nomination and election so that the choice of independent directors was not entirely dominated by the controlling shareholders.

It would be unfair however, to lay all the blame at the feet of regulators. Minority investors have generally shown little interest in the selection of *independent directors*, believing for the most part that they are loyal to the controlling shareholder. And most controlling shareholders appear to remain unconvinced that independent directors have much to offer.

Changing these patterns of thinking would be a slow process and may not be possible for those listed companies that are too small and insignificant to have a following. Investors clearly have a role to play in engaging with companies and explaining that, in their view, independent boards do matter and can make a difference. Some of the questions they could ask include the following.

- Board composition and skills: Is the composition of the board appropriate given the strategic direction and needs of the company? Do the directors have a good mix of skills?
- Board committees: Has the board thought carefully about its choice of committees (given the scope and nature of its business), and why it needs them? Or has it merely followed the local code of best practice and automatically set up committees for audit, nomination, and remuneration?
- Independent directors: Have the independent directors been chosen carefully, not merely for their independence, but for

their business acumen and expertise? An independent director who knows a lot about corporate governance but who cannot read the company accounts or contribute to major business decisions is unlikely to be respected within the board or to add much value.

- Director expertise and values: Do all directors understand what is required of a director, and how the role of a director differs from that of a manager? Do they understand enough about local rules and regulations to help the company avoid regulatory missteps (or advise it to seek outside advice)? Do they understand their legal and ethical responsibilities to shareholders and other stakeholders?

Shareholder rights and responsibilities

As the discussion in Section 2 highlighted, shareholder rights is an evolving area in Asia, with different markets at varying stages of development in terms of formal rules and informal practices. At the top of the agenda for institutional investors over the next five years would be the following issues.

- Proxy voting: Earlier release of final AGM agendas and circulars (28 days before meetings); confirmation from companies (or their share registrars) that votes have been received; confirmation from sub-custodian banks or brokers that voting instructions have been executed; ability to undertake split voting and partial voting; full voting by poll in the AGM (i.e. counting of all votes on a one-share, one-vote basis); independent audit of voting results; and publication of detailed voting results on each resolution within one day after the meeting.

- Private placements: Tighter rules on dilutive placements sought—most investors would like to see such non pro-rata share issuances limited to 10% of a company's total issued capital (or less) in any one year, and discounts of no more than 10% (or less).

- Privatisations/delistings: With the exception of Hong Kong, and to a lesser extent Singapore and Malaysia, protection for minority shareholders where controlling shareholders are trying to delist companies is weak in much of Asia. Regulators need to rethink this issue in consultation with investors and the market.
- Related-party transactions: Most markets have relatively (or extremely) weak controls on related transactions. Again, Hong Kong offers the best model in the region. In addition to mandatory disclosure of transactions above a certain threshold, independent shareholders (i.e. those not interested in the transaction, or are not part of the management or the board) should have the right to approve major transactions in a shareholder meeting. Interested parties and their proxies should be barred from voting in such meetings.

In many parts of the world, notably the US, the UK, and Europe, the global financial crisis has put the spotlight firmly on the role of institutional investors in the economy and what they did (or did not do) to restrain banks and others from taking excessive risks. The popular conclusion is that investors as a group failed to exercise their ownership rights effectively; initiatives such as, for example the UK Stewardship Code, seek to address these problems (FRC, 2010).[15]

While these criticisms are valid and certainly apply to most investment institutions, they tend to ignore or gloss over the efforts of a small number of global pension and investment funds which have been consistently devoting resources to corporate governance stewardship and which accept that they do have responsibilities as well as rights.[16] Many of these institutions are members of ACGA, and also of the International Corporate Governance Network (ICGN), and are signatories or founder signatories of the United Nations Principles of Responsible Investment (UNPRI).[17] Both ICGN and UNPRI lay down specific responsibilities for investors in areas of corporate governance and responsible investing; and

while it is still early days, it is fair to say that these principles are beginning to have an impact on the way these investors behave.

Asking investors to act as responsible stewards is much easier said than done, however. Even among institutions committed to this process there is often a disconnect between their corporate governance work and their investment process. For cultural or philosophical reasons, some institutions are more comfortable engaging with companies (and being seen to do so) than others. And almost all institutions face varying conflicts of interest—the classic one being fund managers who work for different masters, including those who have banks as parent companies, pension funds of listed companies, retail investors in a mutual fund, and so on, and who therefore run the risk of offending one or the other client group if they take too strong a public stand on a particular governance issue

A key element in the discussion of shareholder responsibilities—and one that will likely keep this issue on the agenda—is that if investors do not seek to act responsibly, then the effectiveness of their voting and engagement work, and their efforts to strengthen their own rights and the quality of company governance, will be greatly reduced. In other words, being responsible will give them more credibility with companies and regulators, open more doors, improve the quality of the discussion, and produce greater rewards over the long term.

This ends our discussion of the progress in corporate governance reforms where the major areas of unfinished business in the context of Asia were identified, and policy recommendations were made that would help to reduce investment risks and raise the quality of capital markets around the region.

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Notes

[1] For an elaboration on this point, see Section 2 of ACGA & CLSA Asia-Pacific Markets (2007, pp. 15–29).

[2] In December 2009, the Tokyo Stock Exchange, under direction from the Ministry of Economy, Trade and Industry (METI) and the Financial Services Agency (FSA), introduced a new rule requiring all listed companies to have either one independent director or one independent "statutory auditor". In the Japanese system of corporate governance, the statutory auditor audits a company's compliance with laws and regulations. It is an institution originally derived from the German "supervisory board", although is quite different in operation and considerably more limited in powers. It is also a role distinct from that of the external accounting auditor.

[3] See http://web.ifac.org/about/member-bodies for a full list of the members of IFAC. (Accessed on 18 August, 2010.)

[4] See www.ifiar.org for details on IFIAR. (Accessed on 18 August, 2010.)

[5] Activism in Korea actually started shortly before the 1997 crisis.

[6] Based on ACGA's knowledge of the voting activities of its members, and the volume of resources they increasingly devote to them.

[7] Based on the involvement of ACGA investor members in the Association's recent advocacy and educational activities.

[8] One exception to this was the influence of the People's Solidarity for Participatory Democracy–Participatory Economic Committee (PSPD-PEC) in Korea on some new rules strengthening shareholder rights.

[9] Voting by poll means counting all the shares voted rather than passing resolutions on a simple show of hands, which gives all shareholders present one vote irrespective of the number of shares they own. This legacy of early company law in the nineteenth century disenfranchises investors with higher stakes and those who cannot attend the meeting.

[10] The mixed quality of corporate disclosure in India was covered by ACGA's White Paper on corporate governance in India (January 2010).

[11] CLSA Asia-Pacific Markets is a founding corporate sponsor of ACGA, and the publisher of CG Watch, a regional survey first published in 2000 (on which ACGA has been collaborating since 2003).

[12] Internal data provided to ACGA in February 2010. This had not yet been published at the time of writing of this paper.

[13] The governance data used by UBS comes from Governance Metrics International (GMI), a New York-based corporate governance assessment firm now part-owned by UBS.

[14] The Big 4 plus Grant Thornton and BDO.

[15] See also the Walker Review (2009) on the corporate governance of banks. http://www.hm-treasury.gov.uk/walker_review_information.htm. (Accessed on 18 August, 2010.)

[16] See for example the corporate governance policies published by ACGA investor members, available at http://www.acga-asia.org/content.cfm?SITE_CONTENT_TYPE_ID=40. (Accessed on 18 August, 2010.)

[17] For more on ICGN, see www.icgn.org. For more on the UNPRI, see www.unpri.org. (Accessed on 18 August, 2010.)