Corporate Governance in Asia: Some thoughts

The value of corporate governance is in question throughout Asia, as it is worldwide, in the wake of the worst global financial crisis we have seen since the 1930s. Traveling throughout the region, you repeatedly hear one question: "why should we follow the corporate standards of those whose actions led to the collapse that severely damaged our economy, through no fault of our own?"[1]

My counter to this question is to point out that, it was not the foundations of corporate governance that one should question, but rather the people who were put in charge to ensure that their boards, and the companies they oversaw, abided by best practices. Directors and senior management "failed to understand and manage risk and tolerated perverse incentives," as the International Corporate Governance Network concluded.[2] Those financial institutions that took excessive risks seem to have approached corporate governance with a "check the box" mentality. To be sure, institutional shareholders, too, deserve some of the blame - and there is much to go around - for having been insufficiently engaged and timid in their demands.

As a consequence, poorly governed businesses have either collapsed or will likely be relegated to the sidelines as the recovery, however unsteady it is in 2010, gathers steam and ushers in a new generation of companies that will profit from being well-governed.

Philip Armstrong: *We are still learning how CG effectively works in practice*

The value of corporate governance lies in the transparency and accountability it demands, and through those requirements, the necessity of aligning a company's interests with those of its stakeholders, including shareowners. Corporate governance shapes and constrains how companies deliver on their promises in their stewardship of their shareowners' capital and their relations with stakeholders. For boards, there is legal accountability to shareowners who have invested capital in the business and, more broadly, responsibilities that derive from the impact of their decisions on the legitimate interests of a wider group of stakeholders.

Study after study shows that companies whose culture, management, and mission are defined by corporate governance principles and best practices, tend to outperform and endure far longer than those that don't.

For example, a comparison between the 14 Companies Circle members, which are regarded as corporate governance leaders in Latin America, and a broad basket of 1,078 listed Latin American companies (LAC) shows that the Companies Circle group had an average return on equity of 21.7%, compared to 16.7% for the peer group of LAC companies.[3] Furthermore, the study showed that "Companies Circle members destroyed less value when macroeconomic conditions in Latin America were more turbulent until 2004 [and] created more value when the region became a more stable economic and business environment during the boom period of 2005-2007." The study also found that, on average, shares of Companies Circle firms trade at 21 times earnings per share (EPS), compared to only 16 times EPS for the LAC peer group.

For so-called developing countries and emerging markets seeking to eradicate poverty, the mounting evidence is clear: better companies lead

[1] *The author wishes to thank Jamie Allen, Secretary General of the Asian Corporate Governance Association, for his counsel and expert insights in preparing this article, and for the assistance rendered by Forum consultant and advisor James Spellman and Forum senior projects officer responsible for the Asia region, Eugene Spiro.*

[2] *International Corporate Governance Network, "Statement on the Global Financial Crisis." November 10, 2008. Available at: http://www.iasplus.com/ resource/ 0811icgn.pdf.*

[3] *International Finance Corporation, Organization for Economic Co-operation and Development, Global Corporate Governance Forum, Practical Guide to Corporate Governance: Experiences from the Latin American Companies Circle. October 2009. Available at: http://www.oecd.org/document/18/0,3343,en_2649_34813_43626450_1_1_1_37439,00.html .*

to better societies.

Another example of this evidence is provided by Raj Thamotheram, director of responsible investment, AXA Investment Managers. Examining company ratings data from GovernanceMetrics International (GMI), his team found that GMI's research indicated that there was "a positive relationship between their scores and a number of financial measures such as earnings growth and return on equity."[4] Further, "between 2003 and 2007, companies that were upgraded for corporate governance scores were more likely to outperform the benchmark index and vice versa. Companies with higher corporate governance scores tended to outperform those with lower scores when the economic backdrop was more uncertain, with lower scored companies outperforming when economic confidence was improving."

As revealed in the Asian financial crisis of the late 90s, the role of weak systems of corporate and financial governance can significantly accentuate the sort of market crises we have seen over the past decade or so.[5] Poor corporate governance is typically characterized by ineffective boards, weak internal controls and poor risk management, unreliable financial reporting, lack of adequate disclosures, lax enforcement, and poor audits even by accounting firms carrying internationally branded franchises.

Corporate governance as a means of sustainable existence is a conclusion particularly relevant for family-owned businesses, which dominate Asia. (See box on ownership patterns in East Asia.) Most are shuttered by the time that the third generation assumes leadership. As an IFC study points out, "only 5 to 15 percent continue into the third generation in the hands of the descendents of the founder(s)."[6] Aside from poor management, changes in demand, and shifts in macro-economic conditions, family-owned businesses tend to lack the formal structures needed for analysis and decision-making, their futures harmed by informality and a lack of discipline that leads to inadequate consideration of key strategic issues, including succession planning.

Since the financial crisis in Asia, there has been progress generally throughout the region, as Jamie Allen, the secretary general for the Asian Corporate Governance Association (ACGA), summarizes in the chart below (Progress in Corporate Governance

Ownership Patterns in East Asia

University of Texas Professor Mike W. Peng and California State University Professor Yi Jiang examined whether the role of concentrated family ownership and control in large firms in Asia is "good," "bad," or "irrelevant" for firm performance. Their findings vary by country, demonstrating the variances in culture, laws, and regulations that make it hard to draw out broad general trends and recommendations for the region.

Direct Effects of Family Ownership and Control Mechanisms on Firm Performance

	Good	Bad	Irrelevant
Family CEO	Indonesia, Taiwan	Hong Kong	Malaysia, Philippines, Singapore, South Korea, Thailand, Pooled sample
Pyramid structure	Hong Kong, Malaysia, Singapore	Indonesia, South Korea	Philippines, Taiwan, Thailand, Pooled sample

Moderating Effects of Family Ownership and Control Mechanisms on the Family Ownership-Firm Performance Relationship

	Positive	Negative	Irrelevant
Family CEO x family ownership	Indonesia, Taiwan	Hong Kong	Malaysia, Philippines, Singapore, South Korea, Thailand, Pooled sample
Pyramid structure x family ownership	Malaysia	Indonesia, South Korea	Hong Kong, Philippines, Singapore, Taiwan, Thailand, Pooled sample

Source: Mike Peng and Yi Jiang, "Family Ownership and Control in Large Firms: The Good, The Bad, The Irrelevant - and Why," William Davidson Institute Working Paper Number 840, October 2006. Available at: http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp840.pdf. For a view of ownership patterns in East Asia in the late 1990s, see: Stijn Claessens, Simeon Djankov, and Larry H. P. Lang, "The Separation of Ownership and Control in East Asian Corporations." November 23, 1999. Available at: http://ssrn.com/abstract=206448 .

---

[4] *Raj Thamotheram, "Money Saver," Pensions World, February 2008. Available at: http://www.gmiratings. com/noteworthy/axa.pdf. Cited by Jamie Allen, secretary general, Asia Corporate Governance Association, "Assessing Corporate Governance in Asia, 1999-2009: What's in Store for the Next Decade?" Presentation at the Chubb-APEC Seminar, Singapore, October 7, 2009. Available at: http://www.acga-asia.org/public/files/ACGA%20 Presentation%20to%20Chubb,%20Oct%207,%202009.pdf.*

[5] *World Bank, East Asia: The Road to Recovery. Washington, D.C.: World Bank, 1998. Available at: http://www-wds. worldbank.org/external/default/ main? pagePK=64193027& piPK=64187937&theSitePK=523679&menuPK=64187510& searchMenuPK=64187283&siteName=WDS&entityID=0001 78830_98111703550666. See also: Juzzhong Zhuang, "Corporate Governance in East Asia and Some Policy Implications." Asia Development Bank, Economics and Development Resource Center Briefing Notes 14. Available at: http://www.adb.org/Documents/ EDRC/Briefing_Notes/ BN014.pdf.*

[4] *Raj Thamotheram, "Money Saver," Pensions World, February 2008. Available at: http://www.gmiratings. com/noteworthy/axa.pdf. Cited by Jamie Allen, secretary general, Asia Corporate Governance Association, "Assessing Corporate Governance in Asia, 1999-2009: What's in Store for the Next Decade?" Presentation at the Chubb-APEC Seminar, Singapore, October 7, 2009. Available at: http://www.acga-asia.org/public/files/ACGA%20 Presentation%20to%20Chubb,%20Oct%207,%202009.pdf.*

[5] *World Bank, East Asia: The Road to Recovery. Washington, D.C.: World Bank, 1998. Available at: http://www-wds. worldbank.org/external/default/ main? pagePK=64193027& piPK=64187937&theSitePK=523679&menuPK=64187510& searchMenuPK=64187283&siteName=WDS&entityID=0001 78830_98111703550666. See also: Juzzhong Zhuang, "Corporate Governance in East Asia and Some Policy Implications." Asia Development Bank, Economics and Development Resource Center Briefing Notes 14. Available at: http://www.adb.org/Documents/ EDRC/Briefing_Notes/ BN014.pdf.*

[6] *IFC, IFC Family Business Governance Handbook. Available at: http://www.ifc.org/ifcext/corporategovernance.nsf/ AttachmentsByTitle/Family+Business_Second_Edition_English+/$FILE/Englilsh_Family_Business_Final_2008.pdf .*

[7] *OECD, "Corporate Governance in Asia: 10 Years from Now." September 2009. Available at: ttp://www. oecd.org/dataoecd/0/12/43868946.pdf*

in Asia). That said, though, there are many challenges that Asia faces in advancing corporate governance, as is made clear by the September 2009 report of the Asian Roundtable on Corporate Governance.[7] "There is the need for more follow-up on implementing guidelines on fighting abusive related-party transactions, protection of minority shareholder rights and enforcement," the report said. Further, "there needs to be more focus on controlling shareholders; an examination of different ownership models (e.g. family and state-owned listed companies) and how they impact board oversight as well as a more effective regulatory framework." The ACGA also cites corporate disclosure as a priority area requiring attention in the region.

In the aftermath of the region's 1998-1999 financial crisis, corporate governance was seen as part of the fundamental responses needed to rebuild the economies. And, indeed, much of the variation in performance after the crisis "can be explained by corporate governance problems."[8] Today, it is fair to suggest that that point remains true.

The Role of the Global Corporate Governance Forum

If Asia needs to continue improving its companies' adherence to corporate governance best practices, what are the priorities?

At the Global Corporate Governance Forum, we have focused our efforts in the region in six areas:

- Build awareness for the business case for corporate governance;
- Help the countries in the region build capacity through the establishment and development of institutes of corporate governance and director training associations;
- Work with regulators, stock exchanges, institutes, business leaders and international investors to build consensus around reforms needed to enhance market integrity and corporate performance;
- Train board directors, helping them to develop leadership skills necessary to support these efforts, in advancing corporate governance in the companies whose boards they sit on;
- Educate journalists about corporate governance so that they, in their roles as opinion leaders, can write illuminating articles about the topic and investigate both good and poor practices to highlight the benefits of good corporate governance; and,
- On a selective basis, provide modest support to research projects in cases where such activity reinforces technical assistance interventions, such asthrough the Emerging Markets Corporate Governance Research Network.

One key step in a country's transition towards improving corporate governance is the completion of the World Bank's Reports on the Observance of Standards and Codes (ROSC). The ROSC process identifies weaknesses that may contribute to a country's economic and financial vulnerability. The Forum has worked with the World Bank on follow-up to its corporate governance ROSCs in Indonesia and Bangladesh, for example.

Much of the Forum's work in Asia and elsewhere flows from, and is based on, a series of toolkits that the Forum has produced in recent years in response to the most pressing needs associated with corporate governance reform. For example, establishing institutes of corporate governance, or director training associations, is an important early step for a country or region in making progress and building capacity to train directors about their roles and responsibilities on boards. The Forum has developed a "toolkit," *Building Director Training Organizations*, to help in this area. The toolkit

Progress in Corporate Governance in Asia

Area	Improvements
Financial Reporting	More detailed disclosure rules; faster reporting; quarterly reporting; disclosure of "material" events, director pay, director dealings.
Board composition and function	Introduction of independent directors, board committees, director training; higher expectations placed on directors; higher fees paid to directors.
Shareholder rights	Formal rights strengthened; retail activist groups formed; institutional investors started voting their shares and taking engagement more seriously.
Accounting/auditing	Local accounting standards brought more into line with international standards (ditto auditing standards); independent regulation of audit profession in some markets
Regulatory enforcement	Financial regulators still under-equipped, but there has been more focus on enforcing listing rules and key securities laws (e.g., insider trading)

Source: Jamie Allen, Secretary General, Asia Corporate Governance Association, "Assessing Corporate Governance in Asia, 1999-2009: What's in Store for the Next Decade?" Presentation at the Chubb-APEC Seminar, Singapore, October 7, 2009. Available at: http://www.acga-asia.org/public/files/ACGA%20Presentation%20to%20Chubb,%20Oct%207,%202009.pdf.

[8] *Masaharu Hanazaki and Qun Liu. "The Asian Crisis and Corporate Governance_Ownership Structure, Debt Financing and Corporate Diversification." CEI Working Paper Series, No. 2003-18. July 2003. Available at: http://cei.ier.hit-u.ac.jp/working/2003/2003 Working Papers/wp2003-18.pdf .*

(available in English, French, and Spanish) distills practical experience from 17 developed and developing countries and provides practical advice on building organizations that train corporate directors in sound corporate governance practices. While, in Asia, institutes of directors have largely been established earlier in response to the crisis of the late 1990s, a number of the region's institutes continue to benefit in terms of capacity- and institution-building from Forum intervention, particularly in the case of the Institute of Directors of East Asia (IDEA.net), with whom the Forum is working on *Board Leadership Training Resources* programs (see below).

Another toolkit has been very helpful to countries developing corporate governance codes: Developing Corporate Governance Codes of Best Practice (available in English, French, Spanish, Russian, and Arabic) sets out a step-by-step approach that provides guidance on how to develop, implement, and review a code that defines the required boardroom standards and practices in countries, beyond the minimum legal requirements. As in the case of director associations, in Asia, codes are an area where the Forum is supporting ongoing assistance through the provision of peer review and commentary by the Forum's private sector advisors and expert fraternity, as recently in The Philippines.

In May 2008, the Forum rolled out the Corporate Governance Board Leadership Training Resources in the Asia region through a series of training-of-trainer workshops, first in Dhaka for a regional group of participants from five South Asian countries, followed by similar workshops in India and Indonesia (the latter for IDEA.net). This unique product provides a comprehensive set of materials and learning tools aimed at enhancing the role that directors play on their boards. It also provides approaches that coach directors and managers on internationally acknowledged good practices. The emphasis throughout the training is on developing leadership and analytical skills, drawn from director training materials and experiences in both developed and developing countries (e.g. Australia, Brazil, Indonesia, The Philippines, and South Africa).

> ***"The Board Leadership Training Resources is unique in placing emphasis on training which seeks to maximize discussion and debate through interactive learning techniques that enrich the training experience for board directors and management"***

The *Board Leadership Training Resources* is unique in placing emphasis on training which seeks to maximize discussion and debate through interactive learning techniques that enrich the training experience for board directors and management. By encouraging participants to draw on personal experiences, their development is reinforced by sharing knowledge and boardroom practices in a way that addresses the practical challenges that many directors face. In India, the Forum has actively supported its local partners (the National Institute for Securities Markets and the Confederation of Indian Industry) in carrying this initiative to the next phase. For example, we have helped convene a series of Directors' Colloquia in which directors and senior managers participate in leadership and capacity-building activities based on the Training Resources.

The Forum's global Media Training Program, in partnership with Thomson Reuters Foundation, has been supporting the training of financial journalists in Asia to improve their understanding of corporate governance and reporting. The program comprises a series of workshops, development of a Media Toolkit and a Facebook-based outreach program to engage journalists worldwide on the topic of corporate governance. The initiative covers different areas important for investigative reporting on corporate governance topics and includes practical writing exercises as part of the training workshops. The program also weaves in perspectives on corporate governance from industry leaders, capital markets professionals, regulators, and institutional investors. Workshop coaching sessions help participants develop basic technical skills needed to understand financial reporting, the best ways to "sell" stories to editors, and approaches to investigative journalism based on other journalists' experiences. In an effort to build interest in the subject and to galvanize discussion among media professionals, the Forum has created a Facebook-based "Virtual Press Club" as a space for communication among journalists interested in corporate governance reporting. This network also allows training alumni to share experiences, post stories they have had published, and comment on the exchange of opinions and news.

In some instances, the Forum has deployed various elements of its suite of products and assistance initiatives simultaneously. In India, for example, the Forum's work has been supported by ongoing research on company performance related to corporate governance practices at listed firms. The India program, funded by a generous grant from the Government of Japan, also encompasses media training and engaging local business leaders and domestic and international investors in providing the regulator with recommendations for reform, in addition to the work mentioned above. Board Leadership Training Resources activities have also been deployed in China, and are planned, alongside media training, for Mongolia and Vietnam. In Vietnam, the Forum will also deploy technical assistance in the area of corporate governance dispute resolution (based on a forthcoming toolkit).

Assistance in preparation and refinement of corporate governance codes has been provided to Cambodia and The Philippines. In the case of the latter, the codes work has been in the context of a broader initiative, undertaken by the Philippine Stock Exchange, to introduce mechanisms to encourage corporate governance reform among listed companies, in particular through establishment of a dedicated listing segment modeled on Brazil's Novo Mercado. The Forum is examining other areas where it might lend support in The Philippines to this worthwhile initiative.

As noted above, in the interest of implementing ROSC recommendations, the Forum is preparing an action plan for Bangladesh in partnership with the Bangladesh Enterprise Institute, focusing on a Board Leadership Training Resources program, media training, and alternative dispute resolution approaches for corporate governance disputes.

In March 2010, the Forum will partner with the Indonesian Institute for Corporate Directorship (IICD) on a pilot program to unveil a new module for the Board Leadership Training Resources that is tailored to bank directors. This material is intended to guide financial institutions to review existing corporate governance practices and policies, and put in place reforms that will seek to safeguard them from the sort of financial crises that have plagued western economies more recently. The Financial Markets Recovery Project draws on the latest thinking on bank risk management following the 2007-2009 global financial crisis.

The IICD is helping to contextualize this project's training module to circumstances in Indonesia, roll out the initiative via training of trainers workshops, and design a training program conducted by the Institute itself. The broader plan is to then launch the initiative regionally, through IDEA.net, from the Indonesian platform.

On reflection, many efforts are underway throughout Asia led by the Forum and other institutions to advance corporate governance best practices, initiatives that are seen as essential to sustainable economic development. The challenges are particularly acute for the region as family-owned enterprises, the dominant form of companies, reach a crossroads between expansion and extinction. As an OECD study concluded in 2007: "In many cases, Asian rules now reflect the most developed thinking on established corporate governance systems. However, enforcement remains a significant challenge and 'an unfinished agenda.'"[10] That observation remains true today, with the efforts to help economies recover, driving advances in corporate governance. ■

Issues Confronting Board Directors

There are many issues that boards confront today in Asia, issues that are similar in many ways to those before boards and their companies worldwide. As Jamie Allen, Secretary General of the Asia Corporate Governance Association, outlined in his October 2009 presentation, "Assessing Corporate Governance in Asia, 1999-2009: What's in Store for the Next Decade?", these issues include:

- Are companies getting the most value from their boards?
- Board composition: More focus on linking board composition to strategic direction and needs.
- Board committees: More thought will be given to the choice of committees, how they operate and what they should achieve.
- Independent directors: A growing recognition that, if selected well and given "voice," they can bring value.
- Director expertise: The word "training" is despised by most directors. Yet a good director is an informed director. Knowledge needs to be updated.[9]

"The Financial Markets Recovery Project draws on the latest thinking on bank risk management following the 2007-2009 global financial crisis"

Philip Armstrong heads the Global Corporate Governance Forum, based in Washington DC, United States. Donors to the Forum include the IFC and the Governments of Austria, France, Luxembourg, the Netherlands, Norway, and Switzerland.

Armstrong is an internationally acknowledged expert on corporate governance. He has had a distinguished and varied career in executive and senior management in a number of South Africa's prominent listed companies.

Armstrong has served with distinction on a number of boards of companies, governing bodies of professional institutions, and policy initiatives in South Africa and internationally.

In 2006, he was conferred with an honorary doctorate in business administration from the Oxford Brookes University in the UK in recognition of his contributions to corporate governance internationally, with particular reference to developing countries and in 2009 he was named one of the Most Influential People in Corporate Governance by Directorship.

Armstrong works extensively with governments, regulators and policy makers, institutions and organisations, companies and boards in the private and public sectors globally on issues of corporate governance policies, standards, practices and implementation.

[9] *Jamie Allen, Secretary General, ACGA "Assessing Corporate Governance in Asia, 1999-2009: What's in Store for the Next Decade?"Presentation "Asia's New Market Realities"Chubb-APEC Seminar, Singapore, October 7, 2009 Available at: http://www.acga-asia. org/public/files/ACGA%20Presentation%20to%20Chubb,%20Oct%207,%202009.pdf.*

[10] *OECD, Enforcement of Corporate Governance in Asia: The Unfinished Agenda. Available at: http://www.oecd. org/dataoecd/43/15/42365100.pdf .*