THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Conference on

"CORPORATE GOVERNANCE IN ASIA: A COMPARATIVE PERSPECTIVE"

Seoul, 8-9 March 1998

- Synthesis Note -

1. General remarks

In the context of its special programme on non member economies affected by the financial crisis, the OECD Centre for Co-operation with Non Member Economies (CCNM) organised a senior experts meeting on "Corporate Governance in Asia", which took place in 3-5 March 1999 in Seoul. The meeting was co-hosted by the Korean Development Institute (KDI) and the Korean government and was co-sponsored by the Japanese government and the World Bank.

The meeting proved to be very successful in bringing together a group of high level officials, private sector decision makers and academic experts from several Asian non- member countries (Chinese Taipei, Hong Kong China, India, Indonesia, Malaysia, the People's Republic of China, the Philippines, Singapore, Thailand) with their OECD counterparts in a frank and fruitful exchange of views on the issue of corporate governance (see attached list of participants). The debate developed around a set of country papers on corporate governance arrangements in the above countries (see attached agenda) and a set of substantive presentations by experts and consultants, including presentations by OECD,KDI and the World Bank experts.

The continuing relevance of corporate governance as one of the main factors in the 1997-98 crisis and as an area of major policy reform was underlined by all participants. Deputy Secretary General Joanna Shelton focused on the important role that the OECD Corporate Governance Principles are expected to play in the design of reforms and the international policy dialogue that would develop around them. Most of the countries declared their readiness to use the OECD Principles, as a main benchmark and a gauge of progress in the context of this dialogue. Senior representatives from international organisations (Vice President Shin of the Asian Development Bank and Director Iskander of the World Bank) joined Ms. Shelton and key participants in expressing the wish to see this type of regional dialogue on corporate governance continued. Co-operation between the OECD and these international organisations was deemed to be of central importance in the development of regional fora to facilitate dialogue and the identification of specific country needs in the area of corporate governance.

The following are some of the main policy conclusions are drawn by the OECD Secretariat, on the basis of the presentations and frank exchanges that took place during the meeting

2. Main Conclusions

Corporate governance has gained increased visibility among policy makers during the last few years. This has been the result of a number of different factors. The increasing globalisation of the capital markets has made it necessary for different systems of corporate decision making and control to become broadly compatible with each other at least in terms of transparency in order to be able to attract investors from other countries. Hence, a trend towards **global convergence** of corporate governance norms can be discerned. In addition to the globalisation of markets, some other factors are also contributing to convergence: a more propitious environment for international co-operation and policy debate after the end of the cold war encouraged by the on-going communications revolution; and a clear convergence of legislative and regulatory trends especially in the commercial law area.

The importance of the overall openness of the economy to **competitive pressure in the product and factor markets** should not be underestimated. Corporate governance improvements will produce their full benefits only if markets are allowed to function properly and transmit their signals to foreign and domestic investors, customers, competitors, creditors and employees. Transparency and accountability will not be effective if the information generated by markets is not adequate.

The Asian financial crisis has played the role of a catalyst in the corporate governance debate. One of the fundamental causes of the crisis is the **lack of effective corporate governance mechanisms**. On one hand, there is weak outside monitoring by stakeholders in firms,capital markets and credit institutions. On the other, there is a concentration of control in small groups of interests that very are often closely connected to the state and the financial sector. The lack of transparency of these arrangements, combined with the increasing, direct or indirect, corporate exposure to international capital markets created vulnerabilities that led to the crisis.

Corporate Asia has been plagued by **over-investment, excessive conglomeration and over indebtedness.** These tendencies have been, to a large extent, a result of poor corporate governance mechanisms. Major shareholder in corporate groups, very often their "founding fathers", sought to retain control and appropriate most of the returns, while broadening their risk base. This resulted in unbalanced risk/return conditions and a perverse incentive structure, which encouraged all of the above tendencies.

To be sure, the fault does not lie only within the countries affected by the crisis. Many Western investors showed a low level of prudence in providing large amounts of financing, in spite of the opacity of corporate governance arrangements and the precious little information on the activities and levels of liabilities of the companies or banks. Nevertheless, and irrespective of what needs to be done on improving the efficiency of international capital flows, **an overhaul of corporate governance arrangements needs to be effectuated in the afflicted countries**, if private, especially overseas investment is to resume and companies allowed meet their financing needs and resume their growth. For this to happen, several areas need to be addressed:

Protection of shareholder rights: Asian economies need to address the adequate -- protection of "outside" investors in their companies. A great part of the corporate governance problem emanates from the fact that transactions between corporations and their major shareholders were not adequately vetted by other shareholders. Such self- dealing was practices were widespread in the region. In addition, the responsibility of directors has not been clearly defined and the "ïnsider" domination of boards is evidence of their rather marginal role in protecting the interests of shareholders (or the company) as a whole. These rules need to be overhauled and listed companies need to show more willingness to protect investors.

Disclosure and transparency: It is now clear that the disclosure regime in most Asian economies was defective. While fundamental accounting standards seem to be in place, implementation was and is at best patchy. Corporate audits were far from accurate in giving investors a true picture of the liabilities in individual companies. Most importantly, the standards for consolidated financial accounting were not operative. Obscure cross -ownership patterns often shifted control in corporations in ways that were not known to shareholders. A web of off-balance sheet liabilities such as cross- guarantees of debt increased the risk exposure of individual companies. It is of the outmost importance that these issues are dealt with in order to increase the confidence of investors

Corporate restructuring and exit mechanisms: in many Asian economies, insolvency laws and their implementation fall well short of the basic functions they are supposed to fulfil in a market economy: to enhance payment discipline, to adequately protect creditors, to provide for a flexible framework for the re-

organisation of illiquid but solvent enterprises and to ensure an efficient re-allocation of resources of failed firms. The exit bottleneck destroys value and raises the cost of capital, especially in the crisis and post-crisis environment. In the wake of the crisis, exit issues sometimes need to be addressed from two perspectives: the more long term reform of the general insolvency legislation; and a crisis-related set of rules on corporate restructuring and work-outs between financial institutions and their major debtors. These special crisis rules need to be well integrated into the general plans for restructuring and recapitalising the banking sector and improving banking supervision.

The role of banks: Fundamental weaknesses in managing risk by creditors were a major issue in the Asian corporate debacle. This was often due to poor governance of the creditor institutions, often captured by their debtors or playing a credit-rationing role for the state. It was also a direct result of national financial sectors being relatively closed to foreign investment.

The role of stakeholders As regards the role of employees, in the current effort to re-structure and give a new direction to corporate behaviour and control, it might be very productive to consult and involve the employees who are often the ones who bear the brunt of these efforts.

But the adoption of corporate governance rules in itself might not be enough for substantially improving the performance of the corporations in the region. There is a great need to **improve the infrastructure**, which ensures an effective implementation of these rules. There are several areas that need to be addressed: improved capacity for the judiciary and for regulatory authorities in the capital markets; the emergence of a set of intermediary market institutions that will keep shareholders informed and assist them in the exercise of their control rights; and the continuing education of corporate directors, leading the behavioural change at the corporate level, without which reforms may never become effective.

The progress to-date: Some of the Asian countries have taken rigorous action to address the problems in the aftermath of the crisis. *Korea*, an OECD member- country, has been at the forefront of corporate and financial sector reforms: it is increasing transparency and independent monitoring of publicly held companies, has outlawed cross-guarantees and other “self dealing” transactions between affiliates and is taking important steps to improve the framework for insolvency. Most importantly, it is opening up to FDI and patient capital, in a move that will not only further integrate the Korean economy to that of its OECD and other partners, but will also play a pivotal role in modernising the corporate governance environment in the country itself. The entry of FDI in the financial sector is particularly encouraging in this respect. *Thailand* is another country which has taken important steps, especially a regards the restructuring of its financial sector and the liquidation of financial companies; a corporate restructuring scheme and improvement of the legal and institutional framework for insolvency are also in progress, while the framework for minority shareholder protection is modernised by capital market authorities and the stock exchange. *Indonesia* is still struggling to put together a functioning corporate governance and exit environment: while informal restructuring initiatives -- the so-called Jakarta initiative -- seem to be starting to work, the newly revamped insolvency regime is not yet producing satisfactory results.

The meeting provided policy makers from public and private sector with valuable insight into their neighbours’ problems and solutions and gave us all a broader perspective on the issues; it has confirmed the direction of the Principles as a non-prescriptive tool for policy debate. Participants also suggested **further areas of corporate governance-related work**, especially in the areas of market exit, smaller enterprises and social responsibility of corporations. In summary, it has been a very productive meeting and should be seen as a first step in a continuing policy debate on the crucial issues of corporate governance.