



Asian Roundtable  
Task Force on  
Related Party Transactions



**Session 2: Decision-making  
process: Responsibility of the  
Board**

Dr. Sidharta Utama,  
Indonesian Institute for  
Corporate Directorship



*Manila, 5-6 February 2009*

# Asian Roundtable Task Force on Related Party Transactions Decision Making Process: Role of the Board

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Indonesian Institute for Corporate  
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# Role of the Board

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- OECD Principles III: The Equitable Treatment of Shareholders
  - Board monitoring/approval on RPT provides ex-ante protection to shareholder rights
  - Might be more efficient than shareholder monitoring approval
- OECD Principles VI: Responsibilities of the Board
  - *Monitoring and managing potential conflict of interests, ...including abuse in related party transactions*
- Independent judgment is crucial to assure effective monitoring



# Background Issues

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- Ownership structure of most listed companies in Asia concentrated in the hand of controlling shareholders.
- These listed firms belong to a group of firms controlled by the controlling shareholder – RPT are common.
- Supervisory board and BOD appointed by shareholders, but controlling shareholders play significant role in selecting them.
- Given these, is it possible to have an effective board that prevent abusive RPT?

# Which RPTs are to be prohibited?

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- Some RPTs are abusive while others may be beneficial for firms (e.g., more efficient internal market).
  - Prohibit definitely abusive RPT? (e.g., personal loans to insiders)
  - Does not prohibit, but subject to system of check and balances as well as disclosure process

# What should be required of an independent director?

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- To provide independent judgments in the decision making process
  - Depart from self-interest behavior
  - Be competent
  - Indonesian Law requires both Supervisory Board (SB) and Board of Directors (BOD) to work for the best interest of the company.
    - IF implemented in practice, ALL members of SB and BOD should exhibit independent judgments in their conducts, which eventually prevent abusive RPT.

# What should be required of an independent director?

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- Most jurisdictions require listed firms to appoint independent directors (commissioners) (e.g., In Indonesia, at least 30% of members of SB are independent commissioners)
  - Definition of independence provided
  - Who should verify their independence?
    - Nomination process: fit and proper by Regulator, external independent party, or nomination committee?
    - Accountability: Evaluation on the performance of SB and BOD (by whom?) and is publicly disclosed (e.g., in the annual report)

# Stronger Role of Independent Directors with Higher Remuneration?

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- Trade-off of higher remuneration: May create incentive to monitor but may impair independence.
- More important: a compensation system that rewards long-term corporate performance rather than short-term profit and that penalizes unethical conduct (including abusive RPT)
  - Balanced Scorecard



## How can independent judgment be enhanced in the decision-making process?

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- In most jurisdictions, parties involved in RPT are prohibited to take part in the approval process of RPT.
  - How to ensure that the rule is complied.
    - Indonesia: certain transactions (including RPT) may need to be approved by SB.
    - Expanding the role of audit committee or establish a RPT committee?
    - Enhancing the independence and the scope of internal auditor? Appointing a compliance director?

## How can independent judgment be enhanced in the decision-making process?

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- Directors/Commissioners/Controlling shareholders are personally liable for company loss if they exploit the company for personal interests.
- Companies are required to develop and make public the policy and procedure for the approval of the RPTs.
- Every year, insiders having authority on making decision have to make statements that they do not have any conflict of interest in all decisions they make and they comply with the code of conduct of the company.

# Thank You

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