

*Fourth Round Table on Capital Market Reform in Asia*

*09-10 April 2002, Tokyo*

**Room Document 21**

**Corporate Governance**

**By Ms. Lilia Bautista**

***ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT***

***Asian Development Bank Institute***

**OECD Round Table on Capital Market Reform in Asia  
CORPORATE GOVERNANCE  
By LILIA R. BAUTISTA  
Chairperson, Philippine Securities and Exchange  
Commission  
ADB Institute, Tokyo, Japan  
April 10, 2002**

The globalization of the marketplace has ushered in an era where the traditional dimensions of corporate governance are being challenged by circumstances and events having an international impact. Inadequate corporate governance and standards of transparency were considered to be among the factors that weakened investor confidence and contributed to the Asian economic crisis and its aftermath.

It is also recognized that with the growing global competition for capital, investment funds will follow the path to those markets that have adopted efficient governance standards, such as acceptable levels of investor protection and board practices, as well as satisfactory accounting and disclosure standards. Investor confidence stems in part from a country's or a market's reputation for good corporate governance. If investors are not confident with the level of disclosure, or if a country's accounting and reporting standards are perceived to be lax, funds will flow elsewhere. Thus, the ability of the market much-needed capital, in this highly competitive environment, is prejudiced.

## **The State of Play of Corporate Governance in the Philippines**

According to Mr. Nestor Stilpon of OECD, we can think of corporate governance as being made of two aspects.

On the one hand, corporate governance encompasses the relationships and ensuing patterns of behavior between different agents in a limited liability corporation. These patterns of behavior define the manner in which managers, shareholders, employees, creditors and key customers interact with each other and give shape to a company's strategy. This aspect we can call the behavioral side of corporate governance and goes deep into the internal structure of the corporate entity.

On the other hand, corporate governance also entails the set of rules, laws, regulations and requirements that frame private behavior. These include the overreaching legislative framework governing corporations, as well as voluntary private codes of conduct and standards. This we can call the normative side of corporate governance. This second aspect of corporate governance encompasses what is more aptly termed as political governance.

These two aspects are not mutually exclusive; instead, they define each other through an iterative process. The normative side helps define the behavioral side, while the behavioral side will cause the normative side to evolve in response to new needs.

Thus, the challenge of instituting corporate governance reforms must begin from two sources – the state, through political governance, by its enactment

of reforms and guidelines duly adapting to the changes in the global environment, and the corporate stakeholders, through corporate governance, by admitting that changes can only occur by policing themselves.

From the time corporations began to exist as creatures of the state, government policies have shaped the corporation's manner of existence. It is the law which created the corporation. And it is the law which allowed it to become what it has become.

Take the case of Enron. Although investigations are ongoing in the case, much have been said about how the law allowed Enron to do what it did. In a nutshell, Enron was able to hide its huge losses from the stakeholders, by an ingenious manipulation of its books, with the blessings of its external auditors, who managed magnificently to use the law and at the same time circumvent it. Here the law included the rules set up by the accounting profession itself which for years has been allowed self regulation.

By such experience do people behind economies learn. And by learning, we amend the law so that no such manipulations can happen again. In the Philippines, the changes were initiated with the enactment of the Securities Regulation Code (SRC), which was partly a reactive legislation to the biggest market manipulation fiasco that the Philippines has ever seen. To date, our Department of Justice has indicted 4 brokers and 5 individuals for the BW scandal. Administrative cases have been filed by the Commission against other brokers found to have contributed to the market manipulation.

The lesson learned in every case is that no law is perpetually perfect. As the times and the global situations change, so must the law adapt. The manner by which such adjustments can be made will definitely vary from one economy to the other. And it is up to every country to determine the manner, the speed and the ingenuity by which it can truly implement and effect corporate governance reforms.

From the Philippines' end, in 2001, we did a conscientious study of corporate governance guidelines of developed markets in order to identify those that are appropriate for implementation in the Philippines. The Commission spearheaded the drafting of a Code of Corporate Governance for Publicly Listed Companies and Issuers. The Code has been submitted for public comments and is slated for implementation within the second quarter of 2002. The Code prescribes among other things, higher qualification standards for directors, higher ethical standards for directors and committees, requirements for independent directors, accountabilities and reporting requirements. Also included in the Code is the formation of more board committees to monitor performance, enhance accountability and ensure an appropriate mix of expertise and experience in the board. Some of these committees are the Audit and Compliance Committee; the Executive Compensation or Remuneration Committee and the Nomination Committee.

Because capital market is information sensitive, strengthening of disclosure requirements is imperative. To this end, the Commission is harmonizing its rules and regulations with international standards. A key initiative is the amendment of the Special Accounting Rules (SRC Rule 68), regarding the financial disclosures of publicly held corporations. Phased amendments in

SRC Rules to incorporate accounting and auditing standards will be made annually, until these standards are fully adopted in 2003. Regulation on external auditors and public companies on accounting and auditing matters will likewise be strengthened, to ensure auditor independence.

The Commission takes the position that corporate governance reforms, while seemingly being imposed by law, must be perceived within the context of voluntariness on the part of those required to adopt them. In other words, implementation of corporate governance reforms must be a collective effort, a systemic based implementation that is initiated by law and sustained with the simultaneous support from the regulator and the cooperation of the regulated. However, it must be said that while the regulator knows very well what its mandate is, the regulated may not, due to certain reasons, the most prominent one of which is personal gain. It is in this sense that we advocate a corporate governance education program that will enable all market players to rethink, and be made aware of, their priorities and values. It should be a common undertaking so that there will be a resetting of traditional minds as to what corporate governance is all about.

### **Asian Companies' Structure**

Closely held companies or family-owned companies were perceived to be a major contributor to the Asian crisis. Close family ties in Asia understandably resulted in close family businesses. Historically and sociologically, Asian firms are principally family-owned and/or controlled. As businesses grew and required public listing, control of families remain significant. Based on a study made of 3980 public companies in nine East

Asian countries – i.e., Hongkong, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand, more than half of publicly listed companies continue to be controlled by families. Japanese corporations were mainly family controlled. State control was significant in Singapore and Malaysia, Indonesia and Thailand. At the extreme is the Philippines and Indonesia where 17.1 and 16.7 % of the total value of the listed corporate assets could be traced to the ultimate control of a single family. The ten largest families in these countries as well as Thailand control half of the corporate assets surveyed. In Hongkong and Korea, the ten largest families control 1/3 of the corporate sectors. The result of such sociology is that voting rights exceeded fund cash-flow rights, i.e., ownership rights. The rising concern in all these is lack of transparency in board actions and management since families do not feel the need for public disclosure. The necessary consequence thereof is that minority shareholders are pretty much kept in the dark as to the actual status of the corporations of which they are part-owners precisely because the large shareholders dominate all decision-making activities involving the company.

Thus, in terms of ownership and control, it is desirable to have companies that are broadly owned. Not only must they be broadly owned, they must also protect the interest of the minority shareholders and ensure that all shareholders are treated equitably.

The Securities Regulation Code, which took effect in August of 2000 already provided for a key changes in the structure of the Boards of publicly-held corporations. First, it was the Philippine Stock Exchange (PSE). The SRC mandated the demutualization of the PSE, converting it from a non-

stock organization owned by brokers to a stock corporation to pave the way for broadening its ownership and in the process, dispel the “old boys club” image of the PSE. To date, the PSE has, as members of its Board of Directors, eight (8) non-broker members, three of whom are independent directors, a majority of total board constitution of 15. On March 8, 2002, the PSE had its first election of its officers under this new structure. While news of certain disagreements as to the manner of voting are widespread, the Commission believes that in the end all the parties will come to the realization of the true meaning of corporate governance, which is to protect the rights of ALL STAKEHOLDERS, which includes the public in general.

Second, as per Section 38 of the SRC, any corporation with a class of equity securities listed for trading on an exchange or with assets in excess of Php 50 Million and having 200 or more holders, shall have at least 2 independent directors or such independent directors shall constitute at least 20% of the members of such board.

This issue of closely-held publicly-listed companies has been addressed by our SRC. We believe it is the right move towards the development of a truly free and transparent Philippine capital market, which is imperative in the strengthening of our financial system.

## **CONCLUSION**

Recently, APEC countries adopted guidelines on corporate governance. These guidelines are patterned after the OECD Guidelines. Such a move is an acceptance that standards of good corporate governance is universal and

that lack of it cannot be justified by cultural differences or the family-owned structure of Asian companies. There may be shares of differences in the implementation of these Guidelines, but by and large, the Code of Corporate Governance adopted by countries in the region adhere to the recognition that there are other stakeholders in a corporation besides the owners, majority stockholders and directors.

No country can be excused from implementing and instituting corporate governance reforms. Non-practice of good governance can be a death sentence for any economy. The OECD, the World Bank and the International Monetary Fund have established the principles and guidelines by which good governance can be had. They have taken the initiatives to fund activities towards institution and implementation of governance reforms. They have sent out representatives to monitor each country's compliance with these reforms. The message has been sent and received loud and clear.

The challenge of managing governance, both political and corporate, must come from a recognition of the fact that both kinds of governance are essential for a country's economic growth. The problem lies not in its conceptualization for the concept of governance is by itself multifarious. Its complexity, however, is made easily understandable by the principles it advocates. As Sir Adrian Cadbury has said, "the principles on which it is based – transparency, accountability, fairness and responsibility – are universal in their application. The way they are put to practice has to be determined by those with the responsibility of implementing them."

What must be kept in mind and not forgotten is that those with the responsibility of implementing them includes not only the regulator, but all stakeholders as well. The success of good governance reforms lies in how much care and concern said stakeholders have in ensuring over-all economic success. It is imperative that all stakeholders practice self-governance and accept that there is attached to their actions a social responsibility. Once this is accepted, corporate governance has really arrived.