An Assessment of the Role of Board of Directors in Building Good Governance:

The Case of Thailand

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The Third Asian Round Table on Corporate Governance

The Role of Boards and Stakeholders in Corporate Governance

4-5 April 2001

Shangri-La Hotel, Singapore

ACKNOWLEDGEMENT

The author would like to thank the following persons for their kind cooperation in providing valuable insights into the role of the board of directors of Thai companies: Mr. Rapee Sucharitkul, Assistant Secretary-General of the Stock Exchange Commission of Thailand, Mr. Praphad Podhiworakhun, Vice Chairman of the Federation of Thai Industries, Mr. Chirayu Issarangkul Na Ayutthaya, Director of the Office of Crown Property and Mr. Chulakorn Singhakowin, President and CEO of the Bank of Asia.

Introduction

Since the economic crisis that sent many companies into deep financial mire, the Thai corporate sector is slowly getting back on their feet. With the ruins of reckless lending and risky investment still looming in the form of non-performing loans (NPLs), the public expects the survived companies to improve their corporate governance. Indeed, the spotlight has been focused on the board of directors, which is often accused of being involved in connected transactions and having turned a blind eye on the company's blatant bad corporate practices or even fraud. To this end, the Stock Exchange Commission of Thailand (SEC), has passed several rules and regulations to help promote more effective board's supervision of management. These include, for example, the requirement of two independent directors and an audit committee. The Stock Exchange of Thailand (SET) also impose additional rules with regard to the disclosure of connected dealings.

Besides regulatory bodies such as the SET and the SEC, foreign investors also play an important role in the development of corporate governance among Thai companies after the crisis. To remain afloat during the difficult times, many listed Thai companies needed to mobilize foreign capital as domestic funding virtually dried up. Some have plans to be listed in stock markets overseas; others have taken road shows to promote their new stock or bond issuance. To be able to attract foreign investors, these companies are pressured to improve their corporate governance infrastructure, which often includes the board of directors. The premium foreign investors placed on good corporate governance is indeed high. According to the report by McKinsey & Company in 2000, foreign investors are willing to pay 27% more for equity shares of listed companies in the SET with good governance standing. Thus, there is no doubt that market pressures also play an important role.

Yet, there are still many companies that remain relatively closed to foreign influences. Claessens (1998)[1] noted that over sixty percent of listed companies in the SET are family-owned. The figure may have declined somewhat over the years, but likely to remain nevertheless significant. It is therefore difficult to make general statements or analyses about the local corporate governance characteristics. The development in this area appears to be progressing in two different tracks: fast track for companies that need to mobilize foreign capital, and slow track for those that do not. It is hoped, however, that through time, competitive forces will help raise the standard of corporate governance of all corporate entities.

1. The General Legal Framework

With ancient ties to the French Kingdom, Thailand adopts the Civil Code. Rules and regulations governing listed company are dictated by the Public Company Act 1992 (PCA), the Civil Code, the SET and the SEC.

The PCA stipulates that a public company can have as many directors as stated in the article of association but must not be less than 5 persons. A survey conducted by Price

[1]Claessens, Stijn, Simeon Djankov and Larry Pang (1998), Who Controls East Asian Corporations? Working Paper Series no. 2054, The World Bank

Waterhouse Management Consultants Ltd. in 1998[2] found that approximately 58% of the surveyed companies have a board size of more than 10 individuals, and approximately 40% of the surveyed companies has a board size of 6-10 individuals.

In terms of the minimum requirements to serve as a member of the board, the law stipulates that the person (1) must be at least 18 years old; (2) must not be a bankrupt individual; (3) must not have been imprisoned for fraud or embezzlement; (4) must not have been removed from government office for fraud. Legal entities are allowed to be board directors. Board directors do not normally own shares in the company, but are representatives of various groups of block shareholders.

Directors are elected by shareholders at the shareholders annual meeting. One share one vote normally applies, although not mandatory. Cumulative voting is the default voting scheme stipulated in the PCA, but companies are allowed to establish their own voting rules in the article of association. In practice, no companies allow cumulative voting.

The length of a director's term may vary from 2 –4 years. However, for firms that choose to have their own election rules, a staggering term is mandatory with one third of the board randomly re-elected each year. Employees do not elect directors.

Since there is not a system of performance evaluation, re-appointment of directors is often automatic, unless the individual director caused obvious damage to the company. However, in very few remote cases where a nomination or a remuneration committee exists, reappointment of directors and executives are not automatic but relies on the assessment of the committee.

There is no requirement in the PCA for public companies to appoint independent directors. However, the SEC and the SET require listed or publicly held companies to appoint at least 2 outside directors who are independent from the major shareholders and the management. The objective is to have directors who are able to provide an effective and unbiased oversight of they way in which the company is managed. They are supposed to safeguard the interest of the company, which includes minority shareholders, against any abuses of the management. They are required to give opinions on the connected transactions and provide comments in the annual report.

A survey of listed companies in the SET conducted by Price Waterhouse Management Consultants Ltd.1998 revealed that most companies simply meet the minimal requirement in terms of the number of outside directors. Only 15% of the surveyed companies believed these independent directors contributed great value to their companies and appoint more than what is required.

The picture may have changed somewhat over the years. Rules eventually become habits. More local companies now begin to appreciate the role of outside directors; their impartial and independent views have proved to be valuable to the company.

[2] Price Waterhouse Management Consultant (1988), Corporate Governance Survey in Thailand, SET publications

3. The Composition of the board

Most boards in Thai companies are still dominated by executive directors, most of who have personal ties with large shareholders. Foreign directors are rare, unless the company has a significant foreign equity share. However, with the need to mobilize capital from overseas, many Thai companies begin to look for professional directors to help push the companies forward in order to meet commitments made with and expectations of foreign investors. An appointment of internationally recognized directors can provide an immediate boost to the image of the company.

High-ranking bureaucrats -- some retired, some still in the middle of their career -- also make popular board of directors of Thai companies, in particular for companies that operate in a heavily regulated environment. Indeed, connections can prove much more valuable than competence in a culture of patronage and in an environment where the rule of law is unclear and not properly enforced.

Independent directors are a relatively new phenomenon in Thailand since the SEC mandated that every listed company must have two independent directors on their boards of directors. Most companies are still struggling whether to shun them or appreciate them, while regulators struggling with how to legislate "independence. The definition of independence according to the SEC is as follows (1) not an employee of the company, its subsidiaries or part of the same conglomerate; (2) do not own more than 0.5% of equity share and (3) not a relative to have special relations with insiders that may obstruct impartiality in forming duty. Indeed, it is difficult to legislate "independence", as one can never exclude all types of personal ties, especially in an environment where patronage is a way of life.

There is an on-going discussion on whether the number of independent directors in a board should be increased to at least half of the total number of directors so that these directors will not be easily outvoted. Such a proposal should be considered carefully, however, due to several reasons.

First, the expected role of outside directors should be reconsidered. Their role is to offer impartial and independent views and oversight that can be valuable to the company's management. It is not to dominate the decision making process of the board of directors. Moreover, as part of the common business practice, there is no real vote taken place in board meeting anyway. Attention should thus be focused instead on ensuring that the environment is conducive to these independent directors in contributing to the company – i.e., access to accurate, timely and sufficient information. If the two independent directors can fulfil their expected role effectively, the company will no doubt recognize their contribution and may voluntarily choose to recruit more independent directors.

Second, there is a severe shortage of qualified directors in the market. The crisis has indeed disqualified many prominent executives and directors; in particular those involved in the failed banking and finance companies. These people have been marked by the public as those from the "old regime", where cronyism and nepotism prevailed.

Third, most outside directors are prominent persons, whose capability and integrity are well recognized by the public. But these people are already heavily over-committed with both private and public tasks. Good reputation is of little use if the amount of time these directors can dedicate to the company is very limited.

Fourth, outside directors are often not familiar with the management of company and will have to rely on executive directors and management for information. Their decisions, though impartial, well intentioned and independent, may not necessarily be optimal for the company. To have outside directors controlling the decisions of the board may therefore, not necessarily be preferable.

4. The Responsibilities of the Board

The average board of directors in large companies meets once a month. For smaller companies, the frequency of the meeting may be once every two to three months. Board meetings usually last one to two hours. The executive board, however, meets more often, two to three times a month, depending on the amount of work that needs to be accomplished. Executive board meetings are usually longer, lasting normally for 3 hours. Executive directors are the ones that execute and monitor tasks in coordination with management, while the board of directors approves tasks, work plans, strategies that have been pre-screened and pre-assessed by the executive board. The main responsibility of the board is to oversee the company's business strategy and business plan and to ensure that the management of the company is consistent with the shareholders' resolution and in compliance with the law.

With the presence of independent directors and an audit committee mandated by the SEC, boards of directors in Thailand are playing an increasingly active role in overseeing the management of the company. The idea of independent directors was initially shunned by the corporate sector. Many believe that it is impossible to legislate independence and that these so-called "independent directors" will be nothing more than those with close personal ties with the large shareholders. However, several companies did try to recruit genuinely independent directors with good professional track records. These companies are finally beginning to appreciate the contributions that these outside directors have made to the company.

Audit committees have also become an important tool for boards of directors. With the committee reporting directly to the board, directors can perform better tasks in overseeing how the company is managed. The audit committee is expected not only to be involved with the audit of the company's finance and connection transactions, but also to perform "compliance audit" in making sure that decisions made by the board of directors are properly carried out by the management. Thus, the audit committee has become one of the main ingredients of the board to ensure the "best interest of the company", which often refers to the bottom line of the company's income statement.

Another key ingredient that contribute to the board's ability to ensure the best interest of the company is the quality of the business plan and strategy proposed by the Chief Executive Officer. If these plans and strategies are clear and well thought out, it will be easy for directors to "steer" the company in the right direction. Otherwise, it would be difficult for directors to assess the situation and will have spent more time in questioning the validity and soundness of the proposed plans and strategies.

While several boards of directors have taken major steps towards improving their effectiveness in performing their tasks as representatives of shareholders, many still maintain the same bad habit of not taking their duties seriously. On this matter, the legal environment is of little or no help in ensuring the accountability of these directors.

Section 85 of the PCA stipulates that directors have to perform their duties in compliance with all laws, objectives and the article of association of the company and the resolutions of the shareholders meetings with care and honesty in order to preserve the interest of company. However, there are no clear interpretations on what constitutes care and honesty. Because of the vagueness of the words of law, there has been very few cases -- if any -- of directors being convicted for neglecting fiduciary duties.

In order to lift the standard of the board of directors among listed companies, the SET has established a set of code of best practice for directors. Each year, companies are expected to report on whether they have complied with the code according to their own monitoring. Whereas not complying with the code does not constitute a violation of the law, false report of compliance is a criminal violation. It has been recommended that fiduciary duties of directors be codified in the law and that audit committees assess compliance to the code.

5. The Decision Making Process

5.1 Board of director's duties

Most decisions are carried out by management or the executive board, which meets more often than do the board of directors. However there are certain specific matters reserved to the board of director's decision. These normally includes:

(1) The budget and any deviation from which that is above a specified threshold level
(2) The company's policy, business strategy and plan
(3) The appointment of high-ranking directors, mainly the CEO and sometimes the Vice Presidents as well
(4) Capital increases or write downs
(5) Dividends
(6) New debt acquisitions

The ability of the board of director to perform their duties efficiently depends mainly on the quality of the management's report and the efficiency of the board's secretariat in preparing documents.

The crucial role of the secretariat is something that is often overlooked. Secretariat duties are often treated only as "extra duties" that staff performs in addition to their regular work. Thus, little attention is paid to the quality of the work beyond what is required by the SEC or the SET. For example, if the board's decisions are not properly recorded and circulated well before the following meeting, directors may end up spending most of their time debating the content of the decisions instead of dedicating the time to more meaningful matters. Likewise, if the agenda of the meetings is not properly defined well ahead of time such that questions and issues are raised unexpectedly during the meeting, directors will not have enough information or time to make optimal decisions.

While the management and the secretariat play important roles in supplying corporate information to directors, directors themselves need to demand information. Sometimes it is difficult to determine what kind of information directors require. Usually outside directors are less familiar with the company's business and its management. Therefore, these directors may require more information than do their peers. They are therefore expected to pose questions to the management that may have unintentionally

omitted vital details. It is thus the individual director's duty to "ask as many questions" as he/she can. In some cases, outside directors are paid "too much" or "too little" to play such an inquisitive role. The question which naturally follows is, can such directors be held liable for their failure to perform their duties according to the law?

5.2 Liability of directors

According to section 85 of the PCA, directors who fail to perform their duties with honesty and prudence are individually liable. Other directors who are not aware of the violation cannot be held liable. Directors can also be held individually liable for misinformation, which is considered a criminal violation. However, it must be proven that the individual director has the "intention" of falsifying the information and prove that damages have been done, which is often difficult. However, shareholders may file a lawsuit under the civil code for compensation if negligence can be proven.

Several sections of the law stipulated collective liability of directors. These include section 91 of the PCA that hold directors jointly liable for

(1) damages to the company caused by a director's failure to perform fiduciary duties stipulated in section 85

(2) approval of loans to directors, employees that is in violation of the law

(3) illegitimate remuneration for directors

(4) disbursement of dividends that are in violation of the law -- i.e., in case where the company sustains a loss unless can be proven that the decision was made with honesty and based on the information or financial report that has been certified by the financial officer or the auditor of the company

(5) negligence in keeping accounts, documentation, and registration according to the requirement of the law unless can be proven that best efforts have been placed to avoid violation of the law.

(6) use of proceeds from sales of equity without proper approval

(7) demands of payments or transfer of assets from sales of securities without proper approval

Section 94 of the PCA also stipulates that directors are jointly liable for damages that result from the following act, unless he or she can prove that he/she did not partake in the following act that constitutes a violation of the law:

(1) Misinformation or concealing financial status and performance record of the company during the sales of company' shares or bonds

(2) Submission of documents to authorities that are false or inconsistent with company's account, registration or documents

(3) Falsification of income and financial statements, shareholder meetings' reports or board of director's reports.

While the law provides ample opportunities for shareholders' to file lawsuits against directors for compensation of , the burden of going through a court process in terms of both time and money pose formidable obstacles for shareholders in exercising their rights. It has been recommended that to save time and money, class-action filing should be allowed and that the director or directors bear at least some part of the cost if found guilty. Alternatively, a foundation for small shareholders may be set up. Small shareholders may deposit shares with this not-for-profit organization that will monitor boards and management or even undertake lawsuits against directors on behalf of shareholders. Indeed, the SEC may partially contribute funding to support such an organization.

5.3 Conflicts of interest at the board level

Besides lack of information and accountability, conflict of interest is another major element that impedes effective decision-making of the board. This problem is particularly severe among Thai companies where there is little transparency and oversight in the way in which they are managed. There are several provisions concerning conflict of interest at the board level in the PCA. The law:

(1) Prohibits directors from holding a position or owning shares in competing companies

(2) Prohibits directors from borrowing funds from the Company. Violation of this particular section will hold all directors who approved such transactions jointly liable for both civil and penal penalties. The latter includes a fine twice the amount of the illegal loans or 20,000 baht, whichever amount is greater.

(3) Prohibits the company from providing financial or non-financial compensation to directors beyond what is specified in the company's rules, unless the decision is endorsed by at least two third of shares present at the shareholder meeting. Violation of this particular section will hold all directors who approved such transaction jointly liable for both civil and penal penalties. The latter includes a fine twice the amount of the illegal loans or 20,000 baht, whichever amount is greater. In practice, however, directors are compensated in terms of free trips whose expenses are filed under the category of meeting expenses.

(4) Requires that conflict of interest dealings be approved by the board of directors, while the individual director with the potential conflict-of-interest must abstain from voting.

(5) Requires that the following types of dealings obtain approval from the shareholders:

- *The sale or transfer of ownership of the business or a significant part thereof to another individual*
- *The purchase or transfer of businesses from other private companies*
- *The amendment, signing or canceling of major contracts*
- *The decision to allow other entity or individual to manage the company*
- *Mergers for the purpose of profit sharing*
- *The signing of all contracts with conflict of interest involving directors must be announced in the company's annual report.*

There are few loopholes in the law. First, connected transactions require approval from the board of directors. This would be futile if most or all directors are associated with the same group of block shareholders as is the case for many listed companies in the SET. Second, most connected transactions are negotiated not by the directors themselves, but through nominees. Since the prohibitions do not cover cases when directors have indirect interest in the connected transactions, connected dealings negotiated by a middleman are beyond the reach of the law. Third, large shareholders are not considered as a party whose interests may be in conflict with that of the company. That is, doing business with large does not constitute a connected transaction. . The SET realized the shortcoming of the PCA, and thus established rules that demand greater disclosure of connected dealings as follows:

- *all connected dealings must be published in a newspaper(1 Thai 1 English) and recorded with related size of transaction in annual reports*
- *dealings with large shareholders or with legal entities in which large shareholders own a controlling share must also be disclosed*
- *all connected dealings with substantial value must obtain approval from three quarters of shareholders . In addition, in calling a shareholders meeting to request for such resolution, the company has to provide an opinion of an independent financial advisor on the suitability of such transaction.*

While the more stringent SET rules are likely to be able to better deter undesirable connected transactions, it is not clear, however, whether failure to comply with the SET requirements constitutes a violation of the law. However, directors can be held jointly liable should the company be delisted from the Stock Exchange. But delisting is not an attractive form of sanction for the SET since it would potentially hurt small shareholders. While the latter can file for damages in court, the cost and the time involved in filing a case often deterred a shareholder from pursuing a court case. Thus, class action needs to be facilitated and the burden of the cost must be borne at least in part by the guilty party.

It is recommended that the PCA be amended to provide clearer and more extensive definitions of connected transactions. Strengthening of the role of the audit committee may also help deter fraud cases arising from connected dealings.

6. The Relationship among Board members and between the Board and other Bodies

The board of director in Thai listed companies has a one-tiered structure. As mentioned earlier, it is often dominated by executive directors. Thus, independent and outside directors play an important role in providing proper checks and balances.

The PCA does not mandate any committee but the SEC and the SET require all listed companies to set up an audit committee by the end of 1999. It also requires that an audit committee must compose of at least 3 independent directors each of whom does not directly or indirectly hold shares in the company more than 0.5% of the paid up capital. This does not exclude (1) executive, employee, worker or consultant who receives salary or other regular benefit from the company or its affiliates; (2) those that may have past direct or indirect financial or other interest in the management or the business of the company or its affiliates in

such a way that the person cannot make independent judgement. It is therefore can be assumed that audit committees may not be independent from management, although it must report directly to the board.

A remuneration committee is not required by law or SEC's regulations. Remuneration of directors requires ¾ of shareholders vote. But since many listed companies are still family run, small shareholders often own less than 10% equity share and thus are not able to regulate the compensation of directors. Large shareholders are thus able to pride excessive compensation to friends and families or "shadow directors". However, several companies that have a significant foreign holding, including the Bank of Asia whose major shareholder is the ABN Amro, are voluntarily introducing remuneration committee for greater transparency and efficiency in personnel the management

A nomination committee is also not required. It has been mentioned in a prior section that a large number of listed companies are still controlled by various groups of large shareholders. Directors and high-ranking executives, most of who are friends and family of large shareholders, often have their term automatically renewed with little concern of performance. The story is again different from companies with a significant foreign equity share. The Siam Commercial Bank, for example, has voluntarily established a nomination committee that will assess the performance of directors and senior executives, as well as screen potential applicants to assist the board in its decision concerning personnel.

In theory, these committees should consist of independent directors. The current practice is diverse, however. But in large organizations, outside directors often become involved in these committees to ensure independence from management. But this does not mean that the committee should consist entirely of outside directors. After all, the committee will have to rely on the company's staff, be they from the audit department or from the executive office department. It is thus important that committee members are familiar with staff and the working environment of the company. It is probably optimal to have a mix of outside directors and executive directors as committee members.

7. Board Remuneration and Training

Directors are often provided with a per-meeting honorarium. Compensation in the form of equity shares or warrants are still rare, but gradually becoming more popular. The table below shows the number of listed companies that have provided equity shares or warrants as compensation for their directors.

year	Equity	warrants	Total
2000	4	25	29
1999	4	12	16
1998	1	6	7

Source: The Stock Exchange of Thailand

Very few directors have had any professional training since until recently, there was not an institute that would offer such training. Since its inauguration in October 1999, the Institute of Directors (IOD) has been offering two programs: Directors Certification Program and Chairman Program.

The question regarding whether every director should be certified has been raised many times in the past. In most countries, director's certification remains voluntary, except in a few countries such as Australia where it is mandatory. For Thailand, the voluntary option would probably more realistic at this stage as there are presently very few certified directors to date. Mandatory certification would imply that most directors would have to enroll in the IoD's course, which can prove to be quite costly for some companies, in particular smaller ones. A suggestion would be to require that all directors specify whether they have undertaken training courses for directors as part of their credentials.

8. Conclusion

The face of the board of director in many Thai companies is undergoing major changes as a result of both commercial necessities and increasingly stringent rules and regulations. Yet, there are many other boards that still function in the same old ways with little accountability to peripheral shareholders. It is only through time that the change in the business culture and the force of competition that all companies will come to appreciate that having qualified and competent directors actually "pay". Only then can we hope to raise the quality of the board of director across the board.

Reference

Stock Exchange Commission of Thailand (1999), Enhancing Good Corporate Governance of Thai Listed Companies, SEC Reseach paper available on-line at www.sec.or.th