

## The Third OECD Asian Roundtable on Corporate Governance

### Remarks

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Thank you, Mr. Chairman, and Good morning, ladies and gentlemen.  
It is my great honor to speak here this morning.

I have almost nothing to add to what was said by our three distinguished speakers. I basically agree with everything that was just presented.

So I would like to push things a little bit, and focus on more prescriptive questions about the board of directors - that is, what should we do with the board of directors in Asia?

In my view, what was just said by our distinguished three speakers is a starting point and not the end of the story. We need specific prescriptions in the Asian context. In other words, we now know issues and questions. We do not know the answers yet.

Let me raise (or recall) three specific questions. One, what exactly should the board of directors do? Two, what exactly are the conditions in which the board functions effectively? Three, who should be responsible for the reform of the board - the government or the private sector?

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Let me begin with the first question: what exactly should the board do?

Should the board do a strategic planning? Or Should the board check conflict of interest transactions, as Professor Black emphasized yesterday?

In my opinion, it is not a bad statement that Asia is different from, say, the United States. I think it is not a bad statement in the sense that again as Professor Black pointed out yesterday, from a CG perspective, we should view a broader context, rather than just look at the board.

Two well-known environments that may be relevant in thinking about CG are share ownership structure and the style of finance. In terms of share ownership structure, where share ownership is dispersed, the primary agency problem is between managers and shareholders. In this sense, more or less, the U.S. and Japan have the same problem, that is, the problem of strong managerialism. CEOs are too strong, and the issue is how we should effectively control CEOs. In contrast, where, as we observe in most Asian countries, families and/or the

state have substantial share ownership, the major agency problem we face is between controlling shareholders and minority shareholders. In this context, I see no easy solution by strengthening the board. How should the board do when the interests of controlling shareholders and those of minority shareholders are conflicted? You might say, for example, that cumulative voting should be mandated, but this only transfers the problem into the board room, and does not seem to solve the problem. I must also note that these two models are extremes, and the reality is often found somewhere in-between. So that we have two agency problems to deal with. In my judgment, there is a huge diversity within the Asian region, much larger diversity than we find in Europe, for example. So that the exact prescriptions must be carefully considered in each country in Asia depending on the country-specific situation.

Having said that, as an academic, I have an easy answer. The answer is that the board should maximize the value of the company, not the value of any single constituency. If the board acts to maximize the value of the company, not only the majority/minority shareholders problem would be resolved, but the "stakeholders" problem would be resolved as well. If this is correct, then we should look for how exactly we should encourage the board to act to maximize the value of the company.

I have not yet answered to the question of what the board should do, strategic planning or checking conflict of interest transactions. You might say the board should do both. Fine! The board should do everything. The OECD Principles on Corporate Governance (1998) have a two-page list of what the board should do. The board must be busy if it does everything. I think the emphasis of board activity should vary from country to country, and from company to company. In some companies, strategic planning is important. In some companies, crisis management is important. In some companies, monitoring in a broad sense is important, and so on.

In Japan, in the past few years, more than 200 listed companies voluntarily created the system of executive officers and reduced the number of board members, typically from 40 to 10. Sony was the first company that did this, as Mr. Sano explained yesterday. Why did more than 200 Japanese companies do this? The most popular explanation is the separation of strategic planning and implementation. That's fine.

Then how about checking conflict of interest transactions? As Professor Black said yesterday, the role of the board in checking conflict of interest transactions functions only where the courts or the judicial system functions well, as in the U.S. Unless there are intricate rules for the court to review self-dealing transactions as you see in the U.S., the task of the board in checking conflict of interest transactions may not be enforced and therefore may be meaningless. Then what should we do? I have no good answer.

In this connection, I know a somewhat vague notion, "oversight". I like this word

very much. The word "oversight" appears to cover both strategic planning and the check of self-dealings. But the key thing is the cost of enforcement.

In our Roundtable in Hong Kong last year, we discussed the role of the board in overseeing financial reporting. That is rather easy, to me. Because the cost of enforcement associated with financial reporting is relatively less than the cost of enforcement of, say, checking conflict of interest transactions. I want to emphasize therefore that the issue of checking conflict of interest transactions remains to be resolved by effectuating the board, or by designing other mechanisms.

I have no time to talk about the second element of CG outside the board - the style of finance, except to say one word. In many Asian countries, banks, not capital markets, are still the major source of supplying capital. In such countries, we should seriously discuss the CG problem of banks.

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Now, I will move on to the second question: assuming that we know what the board should do, what exactly are the conditions in which the board functions effectively? Here, we have the problem of "form vs. substance" (which was addressed yesterday) - even if we provide a "form" by setting up, say, the audit committee, remuneration committee and so on, that does not mean that the system operates.

Again, there is no easy answer, and I think given the great diversity in Asia, each country should have its own specific solution to the problem.

Setting up committees sounds a good trial. The audit committee, the remuneration committee and the nominating committee all sound fine. But we should keep in mind that it is the board which takes the ultimate responsibility, and it is the board which delegates its task to these committees. In other words, if something happens, it is the board which should act correctly. In this context, I have to be reminded of what Mr. Millstein emphasized yesterday. That is, the board must be empowered to fire the CEO. I'm not talking about the law - the law usually empowers the board to oust the CEO. I'm therefore talking about practice.

I think the U.S. has a culture where the CEO is relatively easily fired when he or she does something poorly (say, the performance is poor), whereas this culture does not quite exist in some countries in Asia or even Europe, except in an extreme situation where a fraud is uncovered or the company goes bankrupt.

Under a U.S. like culture, the key element of the board is independence and perhaps expertise (or sometimes called literacy). If I may use Mr. Millstein's expression, the board must be "independently minded." Otherwise, the ultimate power to fire the CEO would not be exercised in practice.

Here, if I may, I want to mention how the system is built in Japan. Japan adopts the so-called statutory auditor system. The board of auditors must be set up as a separate body from the board of directors, and the role of auditors is both oversight of financial reporting and checking of whether managers comply with laws, regulations and charter provisions. In other words, Japan takes a preventive (or ex ante) approach by requiring statutory auditors to check whether managers do not violate fiduciary duties, including the duty of care. The system sometimes was criticized, but the system may make sense in a culture where a US like culture does not quite exist.

As an academic, I'm not completely sure which system is better. In fact, the Japanese government is currently considering the introduction of a choice between the traditional statutory auditor system and a new system of one-tier board, that is, the board of directors with three committees that were explained by Professor Mak.

In short, the board is an important focus in CG, but how the board operates effectively is not an easy question to which we do not have a single answer. We should continue our dialog on this matter in a more specific context in each country situation here in Asia.

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Finally, the third and last question: who should be responsible for the reform of the board - the government or the private sector?

Again, I am reminded of what Mr. Millstein said yesterday. He said the private sector is the key. Indeed, in the U.S. no law or no regulation requires that the majority of the board must be independent directors. But in practice, it is. As our colleague from Hong Kong noted yesterday, in most countries in Asia, the government and the private sector tend to collaborate rather than hate each other, I think. If so, the government may be expected to do more than providing a minimum legal or regulatory framework. On the other hand, it is not so easy to set up specific rules that would make the board operate properly. We should carefully draw a line between what the government should do and what the government should not do or what the private sector should do. The approach of "best practice" might be attractive, but might turn out to be nothing. Once again here, I think enforcement is important, and whether or not we have an effective ex post review mechanism by the well-functioning courts and judicial system makes a big difference in allocating the responsibility in enhancing CG between the private sector and the government.

Given the diversity in Asia, I think the answer to this important question should vary from country to country. And we should continue our dialog on this question.

Thank you very much.