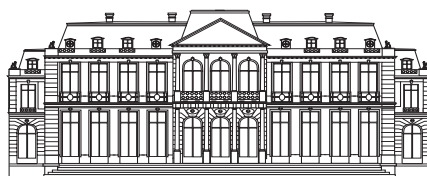


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Conference on

**“CORPORATE GOVERNANCE IN ASIA: A
COMPARATIVE PERSPECTIVE”**

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***Corporate Governance in Asia and the Asian Financial
Crisis: Evidence of the Impact and Current Trends***

Seoul, 3-5 March 1999

CORPORATE GOVERNANCE IN ASIA: A COMPARATIVE PERSPECTIVE
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Disclaimer: These remarks represent personal views and not those of the Asian Development Bank. These remarks were prepared in response to the paper by Nam, Kang and Kim, "Comparative Corporate Governance Trends in Asia".

Session II - Corporate Governance in Asia and the Asian Financial Crisis: Evidence of the Impact and Current Trends

INTRODUCTION

These remarks will question some of the assumptions underlying the usual proposals for improved corporate governance with a view to highlighting how the draft OECD Principles of Corporate Governance could best be applied in Asia.

What is corporate governance? As Joanna Shelton has noted in her opening remarks, corporate governance is used in both a narrow and a much wider sense:

- The narrow sense of the term is the traditional, legal usage: corporate governance refers to the internal relations within the corporate entity that determine decision making power and accountability.
- In the much wider sense, corporate governance has been recently described very aptly by Prof. Kenneth Scott of Stanford Law School:

"In its most comprehensive sense, 'corporate governance' includes every force that bears on the decision-making of the firm. That would encompass not only the control rights of stockholders, but also the contractual covenants and insolvency powers of debt holders, the commitments entered into with employees and customers and suppliers, the regulations issued by governmental agencies, and the statutes enacted by parliamentary bodies. In addition, the firm's decisions are powerfully affected by competitive conditions in the various markets in which it operates. One could go still further, to bring in the social and cultural norms of the society. All are relevant, but the analysis would become so diffuse that it risks becoming unhelpful as well as unbounded" (March 1999).

- In the context of the crisis in Asia, the discussions this morning looked at corporate governance in the wider sense: banking and capital markets supervision and regulation as well as the interaction of the private and public sectors.
- The draft OECD Principles of Corporate Governance, on the other hand, address primarily the narrow, legal sense of corporate governance. Arguably, understood in this narrow sense, failures in corporate governance are not a major contributing factor to the crisis in Asia.

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1. THE THESIS

The thesis of these remarks, which echo those of earlier speakers, is simple: Beginnings determine ends.

- The starting point for any investigation or actions concerning corporate governance in Asia should be the excellent paper by Nam, Kang and Kim of the Korea Development Institute: “Comparative Corporate Governance Trends in Asia”.
- As Nam, Kang and Kim conclude, there is “no instantaneous fix” for the ills besetting corporate governance in Asia.

2. THE DRAFT OECD PRINCIPLES OF CORPORATE GOVERNANCE

In Asia, the OECD draft Principles of Corporate Governance present certain dangers.

- The sheer attractiveness and good sense of the OECD Principles (together with their impeccable pedigree) make it tempting to see them as a quick fix.
- The pedigree itself is a danger (the US, the UK, Europe); the issues have been framed in a different time and place, based on assumptions which may not hold true in Asia.

The OECD Principles do present opportunities as well:

- They can serve as a benchmark, much like the *Objectives and Principles of Securities Regulation* published in September 1998 by the International Organization of Securities Commissions (IOSCO). It is important, though, not to use the OECD Principles as the template or the model; issues should be first framed in the Asian context.

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- The OECD Principles represent a major shift in focus in the debate on corporate governance, from the board of directors to the shareholders. Prior reports and studies, deriving from the Cadbury Report and its far-flung progeny, focussed exclusively on the board of directors, its structure and composition. This preoccupation with the board of directors was a result of the initial terms of reference given to the Cadbury Report which determined the manner in which the issues were framed, a good example of beginnings determining ends. The shift in focus from directors to shareholders is salutary, especially in giving guidance to Asia.
- There is also a lot of good news out there on the corporate governance front generally that will be good for Asia and will help the OECD Principles take root:
- In capital markets regulation (part of the wider definition of corporate governance), IOSCO has been working hard for over two decades now and very tangible results are appearing.
 - The *Objectives and Principles of Securities Regulation* (September 1998), for example.
 - International Accounting Standards (which IOSCO has been instrumental in promoting and implanting) are coming into their own.
 - These are areas where international standards are well defined and make good sense.
- I'd like to sing the praises of the accounting profession. Accounting standards are crucial in Asia and the accounting profession itself can and is doing a great deal to improve corporate governance in its wider sense of protection of public investors.
- Regulation of financial institutions. Again, this is an area where there already exists a good deal of international guidance in the form of international standards.
 - Prudential considerations in the financial industry are fundamental in Asia.
 - The crisis has provided the political will to act.
 - Financial institutions present a particular challenge for corporate governance because, in addition to the usual issues of internal governance, financial institutions are in the business of dealing with other people's money.

3. BURNING ISSUES IN ASIAN CORPORATE GOVERNANCE

There are two issues of primal importance in Asian corporate governance: the ownership structure of businesses and conflicts of interest and self-dealing.

- Concentrated ownership with a predominance of family or state-controlled businesses is the norm in Asia; there are many different variations on this same theme.
- The challenge is to balance the relationship between majority and minority shareholders.
- The draft OECD Principles address both issues but the context in which the Principles were developed has resulted in a different emphasis on the importance of these issues.

4. WEST MEETS EAST: QUESTIONING SOME OF THE ASSUMPTIONS

- Asia is not Asia. Asia is not monolithic. Asia is very diverse, culturally, linguistically, demographically, economically and legally.
- The evolutionary imperative. In much of the commentary on corporate governance issues, the assumption is that the majority-controlled public company is a less evolved form of enterprise, destined either to change or face extinction. This is an assumption worth questioning. Family-controlled businesses have proved remarkably hardy and may very well persist (as they have for centuries, in some cases, in Europe). The widely-held U.S. species of public company may, in fact, be the deviant form. In any event, family-controlled businesses are with us for the immediate future and the particular issues they present should be addressed, rather than explained away.
- Adopting Cadbury's children. The Cadbury Report has spawned a vast progeny. Its influences are identifiable in the OECD Principles in terms of disclosure-based recommendations and the use of voluntary codes.
 - The proposals in the Cadbury Report and the variations spun from them, however, do not necessarily provide optimum solutions; they are quite limited in some respects and have been questioned in terms of the compromises and biases they represent.
 - Even where adopted, the Cadbury proposals have met with a certain amount of skepticism as to their effectiveness.
 - And finally, voluntary codes, relying as they do on a cohesive business community and well-established commercial practices, may be quite inappropriate in parts of Asia.
- Urgency of the crisis justifying drastic measures. It is true that in some parts of Asia there is virtually no commercial legal framework in place. Given this, it has occasionally been proposed that, as an urgent matter, a fully developed Western legal infrastructure be dropped into these countries immediately.
 - As one who believes in the organic nature of legal systems (they grow, evolve, adapt, respond), this would appear misguided. Legal systems should demonstrate balance and coherence. Indiscriminately mixing and matching concepts from different legal traditions, also risks producing legislation that is ineffective, ignored or distortion-producing. Asia is littered with past mistakes of this kind. To drop a concept such as the fiduciary duty of directors into a legal system which does not have the trust as an underlying fundamental legal institution, i.e., the many civil law jurisdictions in Asia, is dropping the concept into the void.
 - As another example, if there is no market for corporate control because of the dominance of majority-controlled corporations, what is the purpose served by U.S.-style tender offer legislation. Better to focus on negotiated transactions and resolve the thorny issue of the control premium.
 - In this regard, especially given the prevalence of "hybrid" jurisdictions in Asia (i.e., those of mixed legal traditions), there is value in looking beyond the "pure" traditions of the United States or the UK to the smaller, developed countries such as the Netherlands, Quebec, or South Africa. Innovation and adaptation are characteristic of their legal traditions.

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- Enforcement. Asia doesn't need better laws; Asia needs better enforcement and better court systems. On the face of it, it would appear hard to argue with effective legal enforcement and a good judiciary. But here it is useful to consider the "role of law" as well as the "rule of law". In commercial matters, recourse to enforcement mechanisms and the courts implies a failure in commercial dealings and the operation of commercial laws, the purpose of which is generally to facilitate and promote good faith commercial activity free of formal government or judicial intervention.

- Certain areas of the law, capital markets and banking, for example, have a large regulatory component and there is no doubt that the "big stick" of enforcement must be real and imminent. However, given the volume of transactions and the limited resources of even the most generously funded regulators, enforcement must be the exception and not the rule in regulating the markets.

- General commercial law, and that includes corporate law, should not rely on enforcement mechanisms as a first line of ensuring compliance. This is certainly the message Ian Dunlop has brought us from Australia. Don't strangle risk-taking activity by overregulation.

- Although this may appear at odds with the above comments on the inadequacy of looking to enforcement mechanisms generally for commercial law, in Asia there may in fact be an argument for encouraging more litigation or other formal dispute resolution where there is a court or other structure to support it. This is a very different business environment from that of the litigious United States; the draft OECD Principles presume a litigious environment in which a balance must be struck between the exercise of legitimate rights and the detrimental effects of excessive litigation. In Asia, the balance is different.

5. *CONCLUSION*

To end with the beginning, it is important to frame the issues for corporate governance in Asia, in Asia. The Nam, Kang and Kim paper is a very good place to start, indeed.