



**The Fourth Asian Roundtable on Corporate  
Governance**

***Shareholder Rights and the Equitable  
Treatment of Shareholders***

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*The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its Member countries, the ADB or the World Bank*

## **Introduction**

Thank you. I'm pleased to participate in this year's roundtable. My name is Vincent Duhamel, and I am the managing director for State Street Global Advisors investment management business in Asia.

I've been asked to address some specific questions today about the global state of shareholder participation and how it can be encouraged in markets where it is only nascent.

I'll discuss how the lack of corporate transparency and the disregard for the rights of non-controlling shareholders can negatively impact company valuations across the market.

I'll also talk about the procedural, legal and regulatory impediments in some markets that continue to keep minority shareholders from actively participating by attending annual meetings or voting proxies.

And I'll conclude with some positive actions that can be taken – and many that are already underway -- by governments, institutions, companies and the press towards improving corporate governance, protecting shareholder rights, and raising the confidence of all market constituents.

## **Corporate governance affects company valuation**

Global institutional investors, while certainly intrigued with opportunities opening up across Asia's markets, remain concerned about the inherent conflicts of interest in the public vs. private ownership of companies in the region.

Increasingly, institutions are linking corporate governance with stock valuations and cost of capital/risk premiums for individual firms and markets as they find that good governance reduces risk and bad governance increases it.

As part of their due diligence, these long-term buy-and-hold investors regard a company's board and management transparency, accountability and overall governance to be as important investment criteria as its financial fundamentals and long-term business strategy.

Investors also look to the market's legal and regulatory supervision and enforcement infrastructure to preserve their shareholder rights when they consider risking capital, both from a theoretical and practical standpoint. Regulators can talk the talk, but we like to see them walk the walk.

In general, countries fall into two groups in terms of overall quality of corporate governance systems and legal infrastructures for protection of property rights – the arm's length model or the relationship model.

The “arm's length” model depends upon checks and balances between an issuer's management, board of directors, majority and minority shareholders. Corporate governance is exercised by portfolio investors through the enforcement of shareholder and creditor rights, and the system relies heavily on the courts to enforce these rights.

In the “relationship” model, corporate governance is exercised by powerful individuals, families, governments or other controlling block-holders, while minority shareholder rights tend to be weak, as does the role of independent board directors.

Generally, investors perceive a lack of understanding of fiduciary duties in relationship-oriented companies – and a disregard for the consequences of underperformance or the failure of good governance.

There is often no effective mechanism for the investor to go in and assess management competence or influence management or board change as a means of improving shareholder value. This unfortunate situation eventually becomes embedded in the company's valuation, through the concept of discounted local pricing.

Investors' rationale is that publicly listed companies using clear, global best practices and standards to value, disclose, govern and preserve shareholder rights merit a “global valuation.” If they continue to use local standards that do not measure up to global best practices, such companies should expect a discounted “local valuation.”

Many investors have adopted the attitude that publicly listed companies – with better access to global investors' capital -- should comply with best-regarded global standards on whichever markets they trade – or accept a discounted share price.

Investor opinion in a range of markets including Korea, Taiwan and Japan, as sampled in 2000 by McKinseys in cooperation with the World Bank, reported that companies that match international standards for best governance, are considered worth 20% more, on average, than peers lacking such standards.

In markets where there is a wide diversity of standards used and little or no regulatory enforcement, without assurance of the quality of information disclosed, investors discount the share prices of all companies.

This drives high quality issuers who can't receive fair value for their shares to seek alternative funding sources. And investors rationally react to the lower average quality of issuers by discounting still more the prices they will pay.

This in turn drives even more high-quality issuers out of the market and exacerbates the adverse selection problem.

Some countries, including the US, have developed a complex set of laws and private and public institutions that give investors reasonable assurance that the issuer is being honest and forthright.

The reputation intermediaries -- accounting firms, investment banking firms, and law firms -- that can credibly vouch for the quality of particular securities face legal liability if they endorse faulty disclosure, and government, civil or criminal prosecution if they do so intentionally.

Unfortunately, although many publicly listed issuers claim that they have followed international accounting standards, anecdotal evidence suggests that the quality of accounting, auditing and financial reporting of these companies needs to be improved substantially.

And currently, no market is ideally positioned to prevent some of the problems recently seen in cases like Enron, WorldCom and others. Despite U.S. standards and long years of precedent, SEC codification, stringent board standards, etc., we still had all these issues crop up.

But there are not many countries that have systems that would punish the culprit as harshly as we're witnessing in the U.S., or act expeditiously to try to improve and resolve its shortcomings.

The U.S. already enacted legislation in July that requires companies to expand and improve the quality of financial disclosures and to tighten accountability of executive leadership and the board of

directors, among other measures. The new law forces company executives of firms that are listed on U.S. public exchanges – including non-US companies -- to vouch personally for the accuracy of their financial statements and extends U.S. corporate governance oversight to foreign companies that list on U.S. exchanges as well.

Clearly, regardless of the regulatory standards adopted, effective supervision and enforcement remains a key challenge across all markets. National accounting associations have played an important role in prescribing audit and reporting standards, however, the current self-regulatory system in many markets does not have the teeth to penalize those who violate standards.

### **Impediments to shareholder participation in corporate governance**

A sound corporate governance system requires that shareholders can actively participate in, and exert influence on, corporate strategic decision-making. If designed well, this can be done effectively through annual general meetings and proxy voting.

Most markets regulate the provision of entitlements, proxy voting, the holding of annual general meetings, and similar events in its own manner, under its own timeframes, and with its own level of rights afforded to the investor.

There are some markets, however, where there are no established practices for proxy voting for all shareholders – for example: Bolivia, Croatia and Qatar.

Meetings of stockholders should provide an open forum for the consideration of management and stockholder proposals, following a specific written agenda made available to all attendees and adhering to a code that governs the conduct of the meeting.

The effectiveness of shareholder participation also depends on the voting procedures, including notification of the dates and agenda of annual meetings and voting and counting methods.

There must be sufficient time to notify beneficial holders in order to meet local voting deadlines. Documentation requirements and timing need to be considered in determining whether voting can be effectively performed.

Unfortunately, a number of legal, regulatory and procedural or bureaucratic impediments are hampering shareholders participation in several markets.

Currently, in many markets, investors often do not receive proxy ballot information in time to lodge a considered vote, or in time to be counted. In Japan, for example, all shareholder meetings are scheduled over a 2-3 day period, which is an impediment to investors' ability to evaluate and analyze all issues on all proxy ballot.

Voting difficulties are compounded by the wide differences in share voting laws and securities holdings systems. In some markets, proxy voting is not permitted, in others, companies communicate with shareholders largely via newspaper advertisements that can often be missed by overseas investors. At State Street, we have experienced this latter problem in Burkina Faso and in Greece.

Issuers and investors often benefit from receiving information from the central depository, however, they often still face difficulties with national central depository systems in receiving sufficiently detailed information in a complete and timely manner.

It is often administratively difficult or cumbersome, particularly for foreign investors, to vote shares in local markets from a distance.

The International Corporate Governance Network published a paper earlier this year that analysed how the rights of ADR holders are curtailed in relation to those of full shareholders. For example, many depository agreements include a disclaimer that there is no guarantee that ADR holders will receive proxy materials in sufficient time to vote.

It is a standard term of depository agreements that ADR holders will only have the right to vote if the issuer formally requests the depository to ask ADR holders for their votes. Some agreements even provide that if ADR holders do not vote, these shares will be assigned to the issuer's management to vote at its discretion.

In addition, standard US distribution methods are not consistently utilized for ADRs, which affects investors' ability to learn and/or evaluate issues on proxy ballots.

Frequent operational challenges to an effective voting process include language translation, timely delivery of information to the end beneficiary, re-registration of shares into beneficial owners' names, tight time schedules, and the need for a physical presence to vote in certain countries.

In Japan, most companies only issue agendas in Japanese, so investors often do not receive translations in their own language until a few days before the meeting.

In many markets, the underlying shares being voted become blocked for trading from the time of the shareholder's election to vote until after the meeting. This is the case in France, Italy, Czech Republic, Slovak Republic, Greece, Portugal, the Netherlands and Switzerland.

Re-registration of holdings required in some markets at a stated date prior to the meeting presents yet another significant operational difficulty in some markets. Often, the assigned re-registration date falls prior to the announcement of the meetings, making it impossible to re-register the shares and secure a vote at the meeting.

Re-registration is required in Norway, Switzerland, Sweden, Finland and Italy.

Some companies require a shareholder or its representative to vote in person, prohibit voting by mail, only permit a proxy to be delegated to another shareholder, or limit the ability of shares to be transferred before the shareholders meeting.

Some markets – including Russia and Hungary -- require documentation that is troublesome to provide – e.g., powers of attorney, articles of incorporate – sometimes per event or annually.

In Singapore only a limited number of proxy cards are provided. Nominees receive 2 proxy cards and must aggregate client votes.

A physical presence is required to vote in a number of markets – including: Norway, Egypt, China Shanghai, China Shenzhen, Czech Republic, Denmark, Hungary, India, Israel, Korea, Mauritius, Philippines, Thailand and Taiwan.

Some countries – including the UK and Pakistan -- permit companies to limit or withdraw voting rights of certain shareholders in their organizational documents or by a resolution at shareholders meetings.

For example, a board Chairman, who is often tied to a company, can decide that a show of hands of shareholders present is sufficient, as opposed to one share one vote.

In such cases, the local depository can often vote its one hand in the direction it deems appropriate as opposed to the position of the underlying shareholders, unless specifically asked by them to vote differently.

Yet another operational challenge occurs in markets that prohibit foreign investors from voting local bank shares – this is the case in Oman and Pakistan.

Cyprus is an example of another market where there is very limited foreign investor voting participation.

In some Eastern European countries – e.g., Russia and the Czech Republic – issuers have the right to reject votes despite full compliance with documentation requirements.

In India, there are also many companies, which are not paying adequate attention to the basic procedures for shareholders' service. SEBI has received many complaints from investors that companies do not pay attention to the timeliness and quality of information disseminated to investors, or redress investors' grievances such as delay in transfer of shares.

Another impediment is the lack of voting process transparency. Public companies should be required to confirm that votes tendered have been properly cast and to communicate this confirmation to the shareholder of record. There should be an audit trail by which the proper handling of votes can be verified.

Another problem is the absence of a standardized and straightforward method for determining who is the shareholder of record entitled to vote in cases where shares have changed hands after the announcement of the meeting.

Another impediment to be lifted is complexity concerning the nature and number of the voting rights applicable to particular securities and the failure of issuers to communicate this information to the first intermediary in the chain. In some cases, for example, one share may carry multiple voting rights; in others, the issuer may have imposed a cap on the percentage of votes that can be cast by a single entity.

Finally, another problem to be resolved is the refusal in some countries to accept split or partial voting. This creates difficulties in markets where the nominee concept is recognized – whereby



financial intermediaries can validly represent their clients. If the ultimate investors have not all directed that their shares be voted in the same manner, the intermediary is unable to implement their instructions.

As shareholders have a right to participate in, and be sufficiently informed on decisions concerning fundamental corporate changes, they should be provided all information relating to material changes such as takeovers, sale of assets or divisions of the company and changes in capital structure which will lead to change in control or may result in certain shareholders obtaining control disproportionate to the equity ownership.

Voting at the general meetings of companies is the most valuable and fundamental mechanism by which the shareholders accept or reject the proposals of the board of directors as regards the structure, the strategy, the ownership and the management of the corporation. Voting is the only mechanism available with the shareholders for exercising an external check on the board and the management.

#### **Removing impediments to participation**

Notwithstanding issues of concentrated ownership and other impediments, shareholders have been increasingly prepared to attend meetings, be more vocal, and organise the minority vote.

There is a groundswell of concern, worldwide with many initiatives and groups forming to conduct advocacy campaigns, provide information and analysis and recommend codes of best practice to raise the level of investor participation.

Governments are reviewing company laws in order to improve participation at shareholder meetings and through the proxy voting process and are looking at allowing greater reliance on new technology for better corporate governance.

Most company acts contain detailed provisions on the minimum and maximum time between calling the annual shareholder meeting and the actual meeting. This helps to reduce the risk of manipulation and should enable especially foreign institutional investors to be informed and obtain documents on time.

Some countries, including Canada, the UK, France and Germany are considering a change to electronic publication of the notice and use of electronic communication techniques in the transmission of voting instructions.

The European Commission has begun an industry consultation period to study proposals that would radically reform the shareholder voting process across Member States.

The EC's consultation outlines two approaches to share voting. The 'chain approach,' which operates in the US and the UK, relies on ballot information and voting instructions shuttling up and down a line of intermediaries that includes registrars, custodians and sub-custodians.

The alternative is the 'direct' approach, whereby companies would be required to provide timely voting information to all shareholders that identified themselves and to process their votes.

Some question the real-world feasibility of this approach, which would present enormous challenges for the issuer and intermediary communities. It would require full and ongoing disclosure from all intermediaries, in turn, requiring issuers to continually monitor and update for changing positions.

Privacy concerns would also be an issue. In markets where disclosure of beneficial ownership is not otherwise generally mandated by law (except in the situations of substantial shareholder reporting, or restricted holdings, etc.), investors often value their ability to invest anonymously in stock and debt. A regime that required the blanket identification of ultimate investors to issuers would destroy this privacy -- with certain consequences for the issuers.

Further, the direct approach could prove quite burdensome for the ultimate investor and would impose substantial burdens on intermediaries at all levels in the chain of custody.

Developing markets need to develop effective ways for issuers to track and inform holders. This kind of infrastructure does not exist in most parts of the world. However, the shareholders that want to be identified do so voluntarily. The burden is on the shareholder as much as on the issuer.

So there is a balancing act that needs to be performed, as well as consideration of methods to preserve investor privacy, such as the OBO/NOBO approach in the US.

Similar issues have been debated in Canada, where a new law was adopted July 1, which is similar to the OBO/NOBO approach in the US.

Meanwhile, the market for commercial corporate governance services via the Internet is also expanding, with several organizations offering information and other services.

Activism by large pension funds in the US and UK that began over a decade ago with groups like CalPERS and Hermes, continues apace. CalPERS recently announced that investment banks and money managers wishing to do business with it will now be required to adopt stringent conflict of interest principles.

In the UK, new legal requirements require pension funds to describe their policies on social issues, and companies to disclose annually the effect of social, environmental and ethical matters on their performance.

There have been some very important developments in Asia as well.

Just last spring, Japan adopted legislation allowing large Japanese companies to introduce a board system with the appointment of independent directors and executive officers for the first time. Japanese pension funds are just beginning to vote their shares.

At Tokyo Style this spring, Yoshiaki Murakami, effectively the top shareholder, began a proxy fight with company management. While the company managed to gain the support of institutional investors and defeat all of Murakami's proposals, this was an unprecedented event of shareholder activism.

In Hong Kong, stringent new measures to promote corporate transparency were adopted in April this year. For the first time, certain types of financial wrongdoing, such as insider trading, became criminal offenses.

And the People's Bank of China has issued guidelines ordering shareholder banks to hire external directors and supervisors for the first time.

### **Governments across Asia have a series of reforms well underway**

All the work being done on capital market development and corporate ownership structure, corporate internal control and shareholder rights protection, and external monitoring and discipline will help bring up the quality of corporate governance to the ultimate benefit of minority shareholders.

Separating ownership and management will help to reduce the conflicts between majority shareholders and minority shareholders. Also, improving the management selection and the promotion process to weed out bureaucracy, reward leadership and create a real meritocracy will help ensure more management accountability to the shareholders rather than to the government.

Government policies that encourage an institutional shareholder base will improve both the overall quality of investors and companies in which to invest.

A long-term, more fundamentally driven investor base is creating pressure on market participants to adopt best-regarded standards and practices to ensure greater predictability and mitigate risk. It also pressures corporate managers to focus more on long-term business development strategies and execution, rather than short-term corporate activities and trading opportunities that prompt continuous restructuring and changes in business focus.

Measures to enhance the quality, competence and independence of intermediaries will boost the quality of corporate governance. Many investors are counting on intermediaries such as accountants, lawyers, bankers and financial analysts to understand and analyse listed companies.

The single most important issue is the independence of these intermediaries as evidenced by full disclosure of potential agency conflicts of interest, objectivity and accountability to the public. This is a global issue that is challenging global capital market confidence.

The Enron-Anderson situation and the investigation of stock recommendations by financial analysts have highlighted this issue and spurred policymakers around the world to investigate their own market mechanisms and take necessary action.

Requiring more timely, transparent and accurate corporate disclosures will provide investors with better information to analyse corporate performance.

To ensure their accuracy, the stock exchanges should specify the minimum content of the reports and hold responsible directors, management and other professionals who prepared or certified the accuracy of the report.

In the US, executive certification of financial results was made a permanent requirement under the accounting legislation signed by President Bush this summer.

Corporations also should capitalize on advances in technology and systems to provide investors with relevant information as quickly as is reasonable.

A system of boards of directors -- and clarification of fiduciary duties – provides a framework for fair, effective ongoing representation of stockholder interests.

As a whole, the board should function to provide broad oversight to executive management, and to provide guidance on strategic priorities and goals. When management performs poorly, the board should have the power to replace it, or open the corporation to a change of control.

Boards of directors can only represent stockholder interests if they operate in a culture that allows for open discussion and independent action by board members. Director independence, however, is largely a “state of mind,” and cannot be legislated or created by regulation. And certainly this is a global problem, not just an Asian one, as Alan Greenspan and others have recently argued.

Some of this culture can be achieved through structural means --- an effective Audit Committee and Executive Committee structure, for example --- but much of it is accomplished through the choice of effective and dedicated directors.

### **Communicating to the investment community**

An entire industry has emerged to support the activist investor community, by producing and sharing company information and by forming groups to advocate changes in law and regulation, to define and to advocate better corporate governance practices and to highlight needed changes in practice on the part of corporations.

Shareholder organizations with different goals and approaches have been established in Hong Kong, Singapore, Malaysia, Thailand, Taiwan and Korea.

And intermediaries are finding a demand by institutional investors for company ratings on corporate governance from groups like CLSA and S&P.

Collectively, there are many ways for governments, institutions, companies and the press and other media to communicate with the investment community to increase shareholder participation and confidence.

The government and regulators can engage in consultations with companies, investors and other financial industry participants. They can prepare clear, understandable proposals and provide an open comment period with adequate opportunity for interested parties to comment on rules and laws and offer alternative, workable solutions before proposals go into effect.

The government can clearly specify the degree of compliance with international accounting standards that publicly listed companies should achieve and establish a supervising agency to regulate and enforce financial reporting practices and standards. If such an agency already exists, it can re-examine and strengthen the agency's powers.

The government can conduct regular dialogues on reporting and disclosure issues among government agencies that are responsible for supervising corporate reporting and national accounting associations.

Investors can use various approaches to help effect change in corporate governance through shareholder activism, relationship investing, quiet diplomacy and proxy voting.

Like corporate board members, fund managers have a fiduciary duty to uphold. This encompasses a duty of care and a duty of loyalty to their investors - to add value and protect their interests in the long-term health of the companies in which they invest.

This is particularly relevant for passive/buy-and-hold or index managers who do not have the flexibility to influence corporate management by simply selling their shares. As the Founder of Deutsche Bank, Georges Siemens once said, "If one can't sell, one must care."

My firm's corporate governance philosophy is to ensure that our clients receive the best possible return on their investments within an acceptable level of risk. As an active shareholder, managing both active and passive funds, SSgA's role is to ensure that corporate policies serve the best interest of the corporation's investor-owners.

The fund management and investment services industries also can actively engage with government and regulatory agencies in a dialogue on these issues, working through trade associations and self-regulatory bodies to publish standards and communicate them to the global investment community.

Large investors can also work with stock exchanges to develop corporate governance standards and rules that will be in the best interest of both listed companies and those who invest in them.

Institutions can carefully examine companies' current practices; see where improvements can be made that would enhance efficiency and long-term business interests, and make their analyses available to smaller investors.

Finally, these institutions can work with some of the associations that have adopted common, well-known principles – so they can, in turn, represent and communicate the current thinking in their own standards and with the rest of the investment community.

For publicly listed companies, the primary goal should be to ensure good performance for all shareholders in the company and to share accurate and transparent company information with the investment community.

Companies should develop procedures for transparency to boost shareowner confidence that a company's board and management are doing the right thing; and it should put in place guidelines governing relationships and disclose guidelines to shareowners.

Executive officers should be charged with promptly disclosing any information publicly to all interested parties, which will influence the company stock price so as to ensure that price reflects its fair value. Regular disclosure shows shareholders, investors, employees, customers, and local communities that the corporation's business affairs have been "above board," efficient and fair.

The role of the press is gathering force and influence across Asia as a facilitator of honest public disclosure. A relatively savvy and sophisticated Asian financial press has accumulated a large readership by identifying a number of scandals and exposing companies that were abusing investors.

### **Conclusion**

Of course, no discussion on corporate governance would be complete these days without mentioning Enron, WorldCom and others. While these cases are terrible -- let me be controversial -- they also provide a lesson in good corporate governance.

These companies' governance structures could have been better and prevented the scandals altogether; but the firms were penalised and paid a high price for their lack of transparency, for the complicity, dishonesty -- and complacency -- of their boards and intermediaries.

The whole financial industry is reacting by trying to improve itself through better standardisation, transparency of financial accounting and reporting, legal remedies and enforcement against corruption.

As the investigation into these corporate abuses continues, we would hope to see a new model emerge for positive collaboration on policymaking for corporate governance. Ideally, a private-public partnership of companies, investors, financial industry participants and individual government and market regulators will work together to help eliminate market barriers by establishing harmonised best practices:

- Adopting globally recognised corporate governance standards that mandate transparency, timeliness and accuracy of corporate financial reporting -- customised within the legal and cultural traditions and norms of individual markets; and
- Enforcing fiduciary laws and shareholder rights through effective market monitoring and surveillance by regulators as well as self-regulatory bodies to ensure investor protection.

Best-practice regulation in these areas that is harmonised globally should reduce compliance costs, remove barriers to competitors and technological innovations and improve access to long-term capital for deserving companies.

All of these factors will result in better protection for investors – instilling their confidence and giving them more and better choices and access to opportunities.

All the new codes and practices being put into place globally won't totally prevent fraud and deceit or other outright criminal activity...but they will help to inspire better behaviour and give companies clear rules to follow and government and industry regulators rules to enforce.

And further, to ensure fair treatment of minority shareholders or proper disclosure, attention must be given to enforcement, legal remedies, and the motivation of, and incentives for, issuers.

The majority of issuers and controlling shareholders must operate in a culture that includes the concept of fiduciary responsibility. They must sincerely believe that it is in their economic interests to treat public shareholders fairly.



Even in environments with the highest ethical standards, there are always those who act wrongly. Thus, the public will always need confidence that in such cases they have recourse to the courts for civil and criminal remedies.

A convergence in legal and regulatory standards across Asia will continue to exert a significant influence on corporate behaviour. And increasingly, institutional activism through partnerships with government, regulatory and industry bodies and companies themselves, will also be extremely influential in bringing about much-needed changes.

Thank you. I would be happy to take your questions.

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