



The 2007 Asian Roundtable on Corporate Governance

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WELCOMING REMARKS

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Opening Remarks
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I am delighted to be here today, and honoured to welcome you all on behalf of the OECD to this meeting of the Asian Corporate Governance Roundtable in Singapore. I am also very pleased to acknowledge our on-going partnership with the World Bank and the generosity of the Government of Japan for supporting our work in the region. I would also like to thank the Singapore Stock Exchange and the Singapore Institute of Directors for co-hosting this meeting. It underlines the strong support for good corporate governance in the Asian region.

It is fitting that this meeting is being held close to the 10th anniversary of the start of the Asian Financial crisis. Corporate governance failures played an important role in exacerbating if not actually causing the crisis. Corporate governance reform became an important element of policy change in the crisis economies (Korea, Thailand and Indonesia) and in their neighbours. For the first time international organisations like the IMF, World Bank, and ADB began to include corporate governance in their crisis response programmes, and the issue became a top priority for the OECD to improve international dialogue between countries. Since then, the Roundtable economies have made a determined effort to improve their corporate governance frameworks and practices—including rules on audit integrity, scrutiny of inter-conglomerate transactions, reductions in the powers of controlling shareholders and increased protection of the rights of minority shareholders.

Good corporate governance not only helps make macro economies more robust to financial crises, but it is also essential to ensure executives don't take decisions that benefit themselves at the expense of the firm and returns on investor's capital. For me the fundamental dilemma of corporate governance is getting the balance right—regulating large shareholder intervention and control appears necessary to prevent their self-dealing at the expense of minority shareholders; but on the other hand limiting the power of large shareholders can also result in greater managerial discretion and scope for abuse. In my past roles as a fund manager at BT Funds in Sydney for 10 years and as an equity analyst at Citi for 5 years I formed the opinion that the correct balance has not yet been achieved in any region of the world, though some are better than others. Executives do need to be given incentives in the form of stock and stock options, but they also need to be monitored and controlled by strong independent boards to prevent abuse. Evidence of abuse is a regular feature of working in the markets, where self dealing and conflicts of interest related to executive compensation frequently lead to:

- Manipulation of earnings, particularly through creative use of the Accruals components of company balance sheets; and
- Related party transactions and transfer pricing that even the most experienced analysts have difficulty following.

Setting the right country rules and regulations helps a lot, but it can only do so much. Firstly, enforcement is always a major problem because of time constraints, access to information and proof of any malfeasance that would stand up in court. Secondly, it is hard to find companies around the world that have majorities of independent directors with zero financial interests and/or who haven't been appointed by some form of cronyism. Third, while hostile takeovers by other listed companies or by private equity, as well as hedge fund activism, are all potential positive forces for good governance, it is too often the case that this is blunted by poison pill defences. Indeed, I worry that private pools of capital may be such a threat to the status quo that it stimulates poison pill and other defensive changes to the capital structures of companies. Fourth, many companies have one block share holder with concentrated voting power that make proxy fights impossible, even for institutional fund managers and pension funds. In fact, most institutional holders of equity rarely become involved in shareholder activism. Those that do, as with the celebrated attempt by Sovereign to gain Board seats at SK Corporation in Korea, find it a hugely expensive, distracting and disappointing process to become involved in.

The ongoing process of reform needs to focus on getting the balance right by helping to reduce the cost and risk of large shareholder activism, strengthening the role of boards and their independence, and looking again at anti-takeover provisions. The benefits of getting this right are potentially huge. In our research in the private sector we found that companies that scored well on corporate governance (including: shareholder treatment; board independence; information disclosure and audit; absence of

accounts manipulation via balance sheet accruals; and absence of transfer pricing and related party transactions) had quite massive out-performance over their peers over longer time horizons. We found that such companies had more highly rated PE's, and their share price performance versus the benchmark on 3, 4 and 5 year returns was very strong indeed. Companies that scored poorly and had managers manipulating accounts for short-term reasons, ended up with lower longer-run returns and weaker sales and earnings growth compared to their peers.

I would like to finish my remarks by touching on why, in my experience, shareholder activism appears to be weaker within the Asian region.

Here the starting point is the greater preponderance of family-owned businesses with large block holdings that traditionally have had less regard for minority interests. This often means that there is not a big enough institutional shareholder who can force management into better corporate governance practices. That is obviously changing, and the Sovereign case in Korea did help in this regard. Institutional fund managers could play a more active role in Asia. But fund managers find that information efficiency is relatively poor in Asia, and this can be strongly to their advantage. The level of corporate access becomes something that can be very valuable to a PM. It is generally recognized that when one has a better relationship with the management of companies in Asia, then getting access to them and getting information from them can be a lot easier. In countries where markets are less efficient in terms of incorporating information into share prices, corporate access can make a large difference to short-term returns! As such, aggressive activism (in the fashion of the US) can be detrimental, as it can potentially damage the relationships a PM or an analyst has with the company. Fund managers can suggest to the company that it should focus on various corporate governance initiatives, but they will never go to the extent of annoying them with this too much, lest they never want to see the person again. In other words, while good governance makes share prices outperform over the 3 to 5 year horizon, fund managers have a shorter focus, and getting information that others don't have can improve short-run performance versus their competitors. Where this involves insider trading, of course, greater enforcement of current rules might help. But this is a very grey area. The need to improve transparency by keeping all analysts fully informed about company developments—with a 'level-playing-field culture needs a lot more work in my view.

In my remarks I have touched upon getting the balance right in both regulation and practice. I have touched on topics such as: enforcement; related party transactions and manipulation of balance sheets via accruals accounting; board independence; poison pill defences; and reasons for the lack of shareholder activism. I hope some of these topics will be a focus of the round table discussion and the declaration that comes out of it. The OECD plays a key role in cooperation and sharing experiences across a number of regions—in major countries, Asia, Emerging Europe, Russia, Latin America and the Middle East. It is our hope that continued improvement in Asia can help set the pace and encourage other regions which lag behind Asia and the West.