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Corporate Governance in Asia
OECD Principals and Beyond

By Mr. Masaaki Kaizuka

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Asian Development Bank Institute

Corporate Governance in Asia
– OECD Principles and beyond –

Masaaki Kaizuka
Principal Administrator
Directorate for Financial, Fiscal and Enterprise Affairs, OECD

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OECD Principles of Corporate Governance and Asian Roundtable on Corporate Governance

OECD Principles

The development of the OECD Principles of Corporate Governance was sparked by ***the Asian financial crisis of 1997-1998***. Although there had been growing interest in corporate governance among OECD Member countries for a number of years, the Asian financial crisis persuaded policymakers world-wide of the necessity to develop common fundamental precepts on good corporate governance.

At the height of the 1997-98 financial crisis, the OECD was asked by the G7 to develop international standards on corporate governance that could be useful to OECD Members and non-Member countries alike. The OECD Principles of Corporate Governance were developed by ***an ad-hoc Task Force***, which comprised government officials, corporations, investors, trade unions and non-government organisations from all OECD countries. Also participating in the task force were the European Commission, the World Bank, the IMF, the Basle Committee on Banking Supervision, and the International Organisation of Securities Commissions. A number of governments from developing and transition countries also took an active part in the consultation process that accompanied the drafting of these standards.

In May 1999, the OECD Principles were formally endorsed by OECD Member countries. While the OECD Principles were developed with publicly listed companies in mind, many of these Principles are also applicable to privately-held enterprises. The OECD Principles cover five main areas: ***1) the rights of shareholders; 2) the equitable treatment of shareholders; 3) the role of stakeholders; 4) disclosure and transparency; and 5) the responsibilities of the board***.

The Preamble to the OECD Principles specifically states that ***there is no single model of good corporate governance***. Rather, the OECD Principles seek to delineate basic corporate governance precepts that will be compatible with many systems. These precepts represent a consensus of the fundamental elements of any good corporate governance framework – fairness, accountability, transparency, and responsible corporate behaviour. However, in order to be operational, the broad, global vision of the Principles must be combined with a "local focus." In other words, ***the Principles need to be interpreted and implemented to take into account the specificities of the national system, the legal and cultural traditions, and the markets in which a company operates***. This approach allows government authorities and the private sector great flexibility to adapt the Principles to their local contexts.

Dissemination of the OECD Principles

At the OECD, we have witnessed various international organisations, governments, investor groups, individual companies, and stock exchanges using the OECD Principles as a blueprint in developing, interpreting, and implementing good corporate governance practices.

At the international level, the OECD Principles of Corporate Governance have emerged as the international benchmarks on good corporate governance. ***The Financial Stability Forum, for example, has identified the OECD Principles as one of 12 core international standards for sound financial systems***. The OECD Principles have also been endorsed by private sector bodies, such as the International Corporate Governance Network, and have served as a reference point in the development of national codes of corporate governance. ***The World Bank and the European Bank for Reconstruction and Development (EBRD) have developed templates modelled after the OECD Principles to conduct country assessments***.

At the regional level, the APEC Ministerial meeting in 2000 welcomed the Asian Corporate Governance Roundtable as an important and useful vehicle for regional dialogue. Furthermore, ***APEC Ministers***, in their meeting on 17-18 October 2001 in Shanghai, endorsed ***the Guideline for Good Corporate Governance Practice*** developed by Pacific Economic Cooperation Council and encouraged APEC members to implement the Guidelines on a voluntary basis. These guidelines provide a non-binding and voluntary framework for the implementation of global practices consistent with the OECD Principles.

At the national level, the corporate governance codes in both Greece and Portugal have been modelled on the OECD Principles. In Asia, corporate governance codes, including those in ***Singapore, Korea and most recently China***, refer to the OECD Principles. In many cases, these codes provide more specific treatment of issues addressed in the OECD Principles. For example, with respect to ensuring the independence of the board from management, the OECD Principles state that board independence usually requires a 'sufficient' number of board members not to be employed by the company and not be closely related to the company or its management. The Korean and Chinese corporate governance codes, however, are more specific. ***The Korean code*** states that board independence requires the board to be comprised of a "majority" of non-executive directors, while ***the Chinese code*** requires listed companies to have one-third of their board members be independent by mid-2003.

An example of how the OECD Principles are interpreted and implemented to fit local conditions can be seen with respect to the issue of separating the chairman of the board and the chief executive officer roles. The OECD Principles is largely neutral regarding the separation of these two positions whereas the Singapore corporate governance code takes the position that the ability of the board to monitor management would be enhanced by separating the two roles. The drafters of the Singapore code reasoned that the heavy presence of executives on Singapore boards, combined with the absence of other disciplinary mechanisms such as an active take-over market, warrants such a separation.

Regional Corporate Governance Roundtables

In addition to these efforts, the main vehicle for promoting the use and implementation of the OECD Principles is through a set of ***Regional Corporate Governance Roundtables***. As of now, such Regional Roundtables have been established in ***Asia, Latin America, Eurasia, Russia, and Southeast Europe***. The Roundtables are organised by the OECD in close co-operation with the World Bank, the International Finance Corporation, the Global Corporate Governance Forum and

key regional partners such as the ADB. The Roundtables have come to enjoy strong support in their regions and high level attention by officials from both the public and private sectors. Over ***an average three-year period***, the primary tasks of the Roundtables are to raise awareness, facilitate an exchange of experiences and formulate concrete recommendations for reform.

While the different Roundtables are all adapted to the specific problems in the regions, they also have two distinct features in common. First, ***they are all using the OECD Principles as a framework for discussions***. Concretely this means that the agendas of the Roundtable meetings typically follow the structure of the five different chapters of the OECD Principles. Second, ***all Roundtables have decided to issue a Regional Corporate Governance White Paper formulating common policy objectives and reform priorities.*** The White Papers will also underline the importance of effective implementation and enforcement and possible needs of technical assistance.

Like the OECD Principles, the Regional White Papers are consensus documents, endorsed by regional Roundtable participants and developed through an inclusive approach considering all relevant constituencies with an interest and expertise in corporate governance. The Russian Roundtable formally adopted its White Paper in March 2002. The other Roundtables will adopt their respective White Papers during 2003.

In addition to the focus on public policy dialogue, the Roundtables have profited greatly from strong private sector participation that has helped foster private sector initiatives in a range of areas, including director training. The vast network of the OECD/World Bank Business Sector Advisory Group has played a key role in this respect.

Asian Roundtable on Corporate Governance

The Asian Corporate Governance Roundtable was launched in March 1999 in Seoul. There have been three meetings so far and the 4th meeting is scheduled to take place in Bombay, India on June 10-12, 2002 focusing the discussion on “the shareholders’ rights and the equitable treatment of shareholders.” The Securities and Exchange Board of India (SEBI) will co-host the meeting along with the private sector.

Participants (ranging from 120 to 150) to the Asian Corporate Governance Roundtable include relevant ministries, securities market regulators, stock exchanges and other concerned groupings from approximately 10 non-OECD economies in Asia, as well as four Asia-Pacific OECD Member countries. The Roundtable also includes senior private sector representatives, investors, trade unions and other regional organisations and associations with a special interest and expertise in corporate governance. ***Following the 4th meeting in India, Asian Roundtable will have a conclusive meeting in early 2003 to approve the final white paper.***

The relevant information on the past Roundtable meetings could be found in our website ***(http://www.oecd.org)*** under the icon of “corporate governance.”

Characteristics of Corporate Governance in Asia

In Asia, there has been great interest in corporate governance because developing good corporate governance is essential to restoring economic vitality to this region and fostering sustainable economic growth and development. ***Deficiencies in the corporate governance regimes of Asian***

economies contributed to the 1997-1998 Asian financial crisis and may have aggravated the crisis once it began, while they may have not been a cause of the crisis.

The Asian corporate governance and finance landscape is often characterised *by* ***1) concentrated corporate ownership, often to dominant families***, and ***2) high leverage ratio with dominance of bank finance in corporate finance***. Therefore, it is necessary to carefully examine whether or how these characteristics have contributed to the aggravation of the crisis.

Concentrated Corporate Ownership

First, ***concentrated corporate ownership (by certain families) is not unique only to the Asian countries but is common to some of the OECD countries as well***. ***Sweden, for example, has a traditionally family-dominated ownership system***. However it also has ***well advanced corporate governance structure***. The Swedish stock market is highly liquid and supported by a market oriented legal framework of company law, securities regulations and disclosure practices. Turn to Asia, ***most listed companies in Hong Kong tend to be controlled by families***. More than 50% of all listed companies have a single shareholder or family that holds a majority share. However, ***Hong Kong maintains relatively high standards in corporate governance and has developed a sophisticated and strong legal system***. These cases suggested that ***concentrated ownership by itself does not necessarily lead to poor corporate governance system***.

Many of the crisis affected countries had or still have common corporate governance problems; the board often failed to exercise proper oversight of management, leading to failures of internal control and increasing the risk of expropriation by insiders. Controlling shareholders effectively have the power to appoint and remove practically all directors. Even among widely held firms, directors are often reluctant to challenge the chief executive officer who in many cases serve as chairman of the board. Limited transparency also remains a source of concern. Accounting and audit standards are different in material ways from internationally accepted practices. In extreme cases, there is no requirement for disclosing essential information, including related party transactions, foreign currency exposures and ownership structures. Even where the requirements are in place, non-compliance is common due, in part, to weak enforcement by the authorities. Insolvency procedures in many Asian countries were largely under-utilised and underdeveloped, thereby diminishing the role of creditors in disciplining the management of poorly performing companies. These deficiencies combined with the concentration of ownership would have contributed to the aggravation of the crisis.

Against this backdrop, participants in the Asian Corporate Governance Roundtable agreed that it is vitally important to establish a proper legal framework and regulatory mechanism to prevent those controlling shareholders from abusing their control rights to expropriate other shareholders, which more concretely includes:

- ***the need to strengthen disclosure requirements, particularly of related-party transactions and insider trading;***
- ***the need to clarify and strengthen the fiduciary duty of directors to act in the interest of all shareholders;***
- ***the need to provide shareholders who suffer financial losses with a private right of action against the controlling shareholders and directors;***
- ***the need to ensure that regulators have the capacity to enforce regulations and monitor companies with the respective requirements;***

- ***the need to establish effective mechanism for corporate restructuring including insolvency framework***

Dominance of bank finance and the role of banks in corporate governance

Dominance of bank finance is also common to many countries outside the Asian region. It could be even said that ***only Anglo-Saxon countries have established a market based corporate governance system***, which has features including 1) dispersed equity ownership with large institutional holdings; 2) the recognised primacy of shareholder interests in the company law; 3) a strong emphasis on the protection of minority investors in securities law and regulation; and 4) relatively strong requirements for disclosure. In the Anglo-Saxon type market based corporate governance regime, ***banks have tended to maintain "arms' length" relationship with customer companies***, which is believed to better prevent the conflicts of interest behavior by shareholder banks. To the contrary, ***German and Japan***, for example, ***have a strong bank centred corporate structure***. German has ***"hausbank" system*** and Japan has ***"main bank" system***, in which shareholder banks assume main responsibilities for most financial transactions of certain companies and have increased controlling power over them through sending in directors or auditors.

In most East Asian countries, it has been pointed out that weak corporate governance results in part from implicit government guarantees of bank lending, unhealthy connections between lenders and borrowers under the relationship-based system and poor bank supervision. Such an environment enabled many East Asian companies to make reckless investments based on heavy debt financing, while financial institutions were discouraged from properly monitoring the soundness of borrowers and managing the risk in their loan portfolios. Taking into account these above-mentioned facts, one could reasonably conclude that it might be oversimplification to attribute "dominance of bank" itself to the aggravation of the crisis.

Furthermore, although capital market development should be among the top policy agenda in Asia and many countries in the region are heading toward this direction, given the current situation in many Asian countries where bank finance is dominant in corporate finance and the equity markets are still in development stage, it is not realistic to expect the establishment of the market based corporate governance as seen in the Anglo-Saxon model over night. Malaysia, for example, has embarked on a decade-long process to shift from a "merit-based"to a "disclosure-based" securities regulatory regime and the process, while progressing well, is still not complete. Therefore, the role of bank should be reexamined from the perspective of enhancing corporate governance practice in the region. The OECD Principles are largely silent on this point.[1] It should be noted that following are necessary conditions in order for banks to play a positive role in corporate governance.

- ***Changing lending behavior away from relationship-oriented one;***
- ***Strengthening monitoring and assessment capability of banks;***
- ***Removing explicit or implicit government guarantee on bank loans;***
- ***Enhancing their own corporate governance;***
- ***Strengthening bank supervision***

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[1] Regarding the role of bank, there is only a general description in the OECD Principles as "the competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of different resource providers including investors, employees, creditors and suppliers."

Beyond the OECD Principles

The OECD Principles have served as a benchmark for many discussions on corporate governance. However, discussions and development in the real world have evolved beyond the Principles and many points suggested in those discussions should be reflected in the future review of the OECD Principles.

Many countries in Asia have formulated their own codes of corporate governance or in some cases amended their related laws, regulations or listing requirements based on the OECD Principles. However, good corporate governance in practice cannot be secured only by the words in those instruments.

Form vs Substance (implementation)

First it is essential for all related players to understand and realize what the words in instruments intend to attain. The issue of independent directors is a good example. In case of Korea, it has been pointed out that while many outside directors have recently been appointed by listed companies as mandated by a new law, there is a widespread fear that many of them have ties to management and are not expected to act in the interest of all shareholders. This case suggested that only a form of outside directors is not good enough to achieve a goal of introducing independent directors as a monitoring mechanism over the management. Appointments of independent directors in practice should be determined based on its real objective.

In short, companies need to be made aware that good corporate governance is in their long-term self-interest and ***companies that truly embrace good corporate governance are more likely to comply with the spirit rather than just the letter of corporate governance rules***.

Enforcement

Secondly, while government should provide a strong legislative and regulatory framework for corporate governance, it should also ***endow in its regulatory agencies strong powers to carry out their monitoring and enforcement functions*** and ***ensure that these agencies are able to impose credible sanctions in cases of non-compliance***. Unless they face serious penalties for such non-compliance or violation of the rules, managers of companies may easily exploit their shareholders or hide information on related party transactions that is harmful to companies. In relation to this, government should also ***allocate sufficient financial and human resources to these agencies*** so that they will not be unduly hampered in fulfilling their responsibilities. In many countries, particularly transition and developing economies, it is often the case that the laws are adequate but enforcement is problematic.

To enhance enforcement of regulations under limited resources for regulators, ***awareness by shareholders of their rights should be enhanced and their activism should be encouraged*** so that they could have a sort of monitoring function over companies.

On a broader level, government should also ensure that ***the legal infrastructure***, particularly the judicial system, function efficiently and effectively so that aggrieved shareholders and other parties will have effective legal recourse against management or the company. It is crucial to ***secure effective remedial measures*** including class action suits available to minority shareholders when dominant shareholders or managers act against their interests. ***Creating specialized courts*** may also be important to facilitate settlements in courts, which makes these remedial measures more realistic options for shareholders.

Flexibility

Finally, it should be borne in mind that a corporate governance system needs to be sufficiently flexible in order to accommodate changing needs and circumstance. Many governments have in fact come to the conclusion that with respect to many corporate governance issues, such as the optimal number of independent directors that should be on a board or whether the roles of the chief executive officer and the chairman of the board should be separated, it is not appropriate to impose statutory prescriptions because ***one-size cannot fit all as all companies operate under different conditions and these conditions are likely to change over time***.

Annex I

Summary of the OECD Principles

In Chapter 1, the OECD Principles recognise the protection of ***the rights of shareholders*** as central to any effective corporate governance system. Basic shareholder rights include the right to 1) secure methods of ownership registration, 2) convey or transfer shares, 3) obtain relevant information on the corporation on a timely and regular basis, 4) participate and vote in general shareholder meetings, 5) elect members of the board, and 6) share in the profits of the corporation. Moreover, shareholders should be able to participate in decisions concerning fundamental corporate changes such as 1) amendments to the company's constitutional documents, 2) the issuance of additional shares, and 3) extraordinary transactions such as mergers and disposition of key assets. The Principles also call for full disclosure of arrangements, such as pyramid structures and cross-shareoldings, that redistribute control over the company in ways that deviate from proportionality to equity ownership.

In Chapter 2, the Principles stress that corporate governance frameworks should ensure ***equitable treatment of all shareholders***, including minority and foreign shareholders. In particular, mechanisms should be developed to ensure that managers, board members, and controlling shareholders are not able to misappropriate company assets to the detriment of non-controlling shareholders. Improper insider trading and self-dealing should be prohibited and personal material interests of board and management members in matters affecting the corporation should be disclosed.

In Chapter 3, the Principles recognise that it is in the long-term self-interest of firms to encourage active participation in the governance process by ***stakeholders***, such as employees, creditors, long- term suppliers and customers. Mechanisms for stakeholder participation include: employee representation on boards, employee stock ownership plan or other profit sharing mechanisms or governance processes that consider stakeholder viewpoints in certain key decisions. It goes without saying that the legal rights of stakeholders should be effectively respected.

In Chapter 4, the Principles call for ***a strong disclosure regime***, acknowledging transparency as a key element of an effective corporate governance system. The Principles call for timely and accurate disclosure of information on such matters as the company's financial and operating results, its objectives, major share ownership and voting rights, remuneration of key executives, and material foreseeable risk factors. This information should be prepared and audited in accordance with high quality standards. In addition to their commercial objectives, companies are encouraged to disclose policies relating to business ethics, the environment and other public policy commitments.

In Chapter 5, the Principles declare that ***the board*** should be the main mechanism for effective monitoring of management and for providing strategic guidance to the corporation. The Principles make it clear that it is the duty of the board to act fairly with respect to all groups of shareholders and with stakeholders, and to ensure compliance with applicable laws. Among the responsibilities of boards are: reviewing corporate strategy and planning; overseeing management (including remuneration); managing potential conflicts of interest; and ensuring the integrity of accounting, reporting and communication systems. The Principles also stress that board members should be able to exercise objective judgement on corporate affairs, independent of management.

Annex II

Asian Roundtable on Corporate Governance

1st Asian Roundtable on Corporate Governance

Date: ***3-5 March 1999***
Venue: ***Seoul***
Host: The Korean Development Institute
Participants: ***9 non Member economies***: China, Hong Kong China, India, Indonesia, Malaysia, Philippines, Singapore, Chinese Taipei and Thailand
12 Member countries: Australia, Canada, Denmark, France, Germany, Japan, Korea, New Zealand, Spain, The Netherlands, UK and US
5 International Organisations: ADB, IMF, IOSCO, TUAC and World Bank
Agenda: Overview of Asian corporate governance

2nd Asian Roundtable on Corporate Governance

Date: ***31May-2 June 2000***
Venue: ***Hong Kong***
Host: The Securities and Futures Commission of Hong Kong
The Stock Exchange of Hong Kong Ltd.
The Hong Kong Society of Accountants
Participants: ***9 Non-Member economies***: China, Hong Kong China, India, Indonesia, Malaysia, Philippines, Singapore, Chinese Taipei and Thailand
10 Member countries: Australia, Canada, Denmark, France, Italy, Japan, Korea, Mexico, UK and US
8 International Organisation: ADB, ADBI, BIS, IFAC, IMF, OECD, TUAC and World Bank
Agenda: ***Transparency and disclosure***

3rd Asian Roundtable on Corporate Governance

Date: ***4-6 April 2001***
Venue: ***Singapore***
Host: The Monetary Authority of Singapore
The Singapore Stock Exchange
The Singapore Institute of Directors
Participants: ***10 Non-Member economies***: Brunei Darussalam, China, Hong Kong China, India, Indonesia, Malaysia, Philippines, Singapore, Chinese Taipei and Thailand
8 Member countries: Australia, Canada, Japan, Korea, Mexico, New Zealand, UK and US
7 International Organisations: ADB, ADBI, Commonwealth Secretariat, IFC, OECD, TUAC and World Bank
Agenda: ***The role of stakeholders and the responsibilities of the board of directors***

4th Asian Roundtable on Corporate Governance

Date: ***10-12 June 2002***
Venue: ***Mumbai/Bombay***
Host: The Securities and Exchange Board of India
Confederation of Indian Industry
Participants:
Agenda: ***Shareholders rights and equitable treatment of shareholders***