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*Reforming
Corporate
Governance
in
Southeast Asia*

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*Reforming
Corporate
Governance
in
Southeast Asia*

Economics, Politics,
and Regulations

edited by
Ho Khai Leong



INSTITUTE OF SOUTHEAST ASIAN STUDIES
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The theme chosen for the Roundtable 2004 was “Reforming Corporate Governance in Southeast Asia: Economic Realities, Political Institutions and Regulatory Frameworks”. Mr K. Kesavapany, Director of the Institute of Southeast Asian Studies, initiated the idea in 2003 and he has been instrumental in providing the motivation and the inspiration for the contents of the seminar. Konrad Adenauer Stiftung generously sponsored the Roundtable.

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Ho Khai Leong
January 2005

FOREWORD

Corporate governance is an idea whose time has, it seems, resoundingly come. That is the impression the observer gets from casting an eye on the plethora of conferences, books, scholarly papers, media reports, and so forth on that subject. The good word of corporate governance has now invaded other areas of life as well. In Singapore, there is, for example, a governance charter for charities.

The remit of corporate governance covers a wide field: the relationship between the board and its shareholders; the composition of the board and its committees; the remuneration of executives; the salience of the audit committee; and not least, the concepts of openness, disclosure, and transparency.

Nobody seriously quarrels with the rapidly evolving trend in corporate governance. How could anyone take issue with laws and regulations and rules and codes that are designed to encourage listed companies to conduct their affairs properly in their own interest?

All those impositions have, no doubt, laid a heavy and expensive burden on companies and their boards. And there is no end to the process. The demands of shareholders will not abate. So, listed companies will just have to brace themselves for a succession of stringent dispensations. Their consolation is the consequent toning-up of management, leading to enhanced performance, which will be, in turn, reflected in the share price.

Even now, the Council on Corporate Disclosure and Governance in Singapore is reviewing the corporate governance code (CGC), activated hardly three years ago, to make it more relevant to the times. The council is taking the pulse of the investing community and listed companies. It will

push the envelope, but in a measured manner in accordance with societal norms.

Despite rapid progress in the discipline of governance, the string of corporate scandals around the world is not diminishing. Nor is the magnitude of their impact diminishing. Even well-regulated jurisdictions, like Singapore, have suffered periodic upheavals.

When such corporate disasters erupt, a clamour arises for the authorities to reach for their armoury of regulatory enforcement and other weapons to address the newly-perceived threat. But that panoply of weapons, however augmented, will not eliminate disasters. Man is both fallible and sinful. So the authorities are increasingly turning to the question of how to improve the assessment of character and integrity of the leaders of companies seeking money from the public.

The Institute of Southeast Asian Studies is to be commended for its initiative in advancing the interest of corporate governance in ASEAN countries. The papers submitted at an ISEAS workshop on “Reforming Corporate Governance in Southeast Asia” have now mutated into a book of no mean size. The editor, Dr Ho Khai Leong, and all the contributors deserve recognition for their arduous efforts. Even if they have given the principles and practice of corporate governance in ASEAN countries just a gentle push, their labours will not have been in vain.

J. Y. Pillay

Chairman

Council on Corporate Disclosure and Governance (CCDG)

4 February 2005

INTRODUCTION

HO Khai Leong

Corporate Governance: A Cross-Disciplinary Study

In contemporary policy discourse, corporate governance has become a by-phrase. It has been used so often and so casually that one accepts it readily as a value which should permeate throughout the contemporary business world. Seemingly a commonsensical term in our vocabulary, on deeper reflection, however, it is actually a complex idea. The discussion of corporate governance can be found in public finance, corporate management, law, economics and political science literatures. Obviously, the apparent relationship between the economic health of corporations and society did not escape the observations of social scientists who are interested not just in one particular facet of evolutionary change but the casual relationships of corporate governance and social development. Given the multi-disciplinary nature of the subject, it is therefore unsurprising that one is unable to find a commonly-agreed definition of corporate governance. However, it is important to start somewhere.

At the most general level, “[c]orporate governance is about promoting corporate fairness, transparency and accountability”. This is the President of the World Bank, James Wolfensohn’s definition, as quoted in an article published in *Financial Times*, 21 June 1999. That is as general a definition one can get about the concept, which, due to its generality, is perhaps more acceptable and continues to attract public attention and gain popularity as such. The Organization of Economic Cooperation and Development (OECD 1999), on the other hand, provides a more detailed, and hence, more meaningful, definition:

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

This is probably the most commonly quoted definition of corporate governance in policy as well as corporate discourse, for it provides the functional perimeters by which scholars and policymakers alike are able to embark on their tasks at hand. Many accept this definition as the most authoritative.

In that regard, it is useful to reiterate the OECD Principles of Corporate Governance. They cover five areas:

1. The rights of shareholders
The corporate governance framework should protect shareholders' rights.
2. The equitable treatment of shareholders
The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
3. The role of stakeholders
The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financial sound enterprises.
4. Disclosure and transparency
The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
5. The responsibility of the board
The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The OECD principles of corporate governance are by no means carved in stone. A general framework has emerged from these principles, enabling Southeast Asian states to mould them according to their unique developmental

experiences to build their own rules. However, scholars and practitioners in Southeast Asian nations have yet to thoroughly discuss these principles, comprehensively and comparatively, so as to emerge with a common platform to further build their own contextual reform agenda.

Corporate Governance in Southeast Asia: Motivations and Consequences of Reforms

Corporate governance, or the lack of it, has emerged as a major policy concern in Southeast Asia especially after the Asian financial crisis in 1997. The weaknesses in the corporate sector — poor investment structure, weak legal and accounting systems, faulty financial practices, questionable political interventions — in Indonesia, Malaysia, the Philippines and Thailand (and Korea), have been identified as having contributed significantly to the sharp economic decline during that particular period of crisis. These countries, learning from painful experience, have since implemented various policy measures to improve the status of corporate governance, which include policy transparency, institutional accountability and fiscal prudence. Corporate governance reform, however, were not limited to these crisis stricken countries. States which have been relatively unscathed by the crisis, such as Singapore, China and Taiwan, were also quick to acknowledge the importance of good corporate governance practices and embarked on various reform efforts of corporate restructuring, based on stronger ethical foundations. They believed that it was better to jump onto the bandwagon instead of to wait for another crisis to strike.

In Southeast Asia today, almost all top policymakers within the state and in the business world have acknowledged that “good” corporate governance — however we define it — is indeed a key to economic recovery. For too long, this issue in development has been ignored, or inadequately considered. It took a sudden and prolonged financial catastrophe for the state and market to realize that negative consequences appeared without proper corporate management. Subsequently, they also began to realize that good corporate governance is also a key ingredient to sustained economic growth.

At the same time, a spectre has spread through Southeast Asia; it is the spectre of intense regionalization and globalization. These are two forces, which at times may be going in different directions and consequently create more tensions within the states, that probably impacted on the Southeast Asian states to be more committed to corporate governance reform. Globalization, technology and deregulation are combining to challenge established corporations. Indeed, the capitalist multilateral system has

continued to put pressure on the governments and private sectors to reform the corporate sector and to adopt the best practices which can withstand the onslaught of global competition. The needs for corporate reform for Southeast Asian states therefore are both necessary and urgent.

Consequently, the governments of these crisis-stricken countries introduced strident corporate governance reforms at all levels: formal and informal, institutional and regulatory, political, economic as well as organizational. They have resorted to various strategies which, by and large, attempted to make a difference to the short- and long-term success or failure of a corporation. While policymakers know very well that good corporate governance reform is dependent on the legal, regulatory, and institutional environments, they are also mindful of other factors such as business ethics, environmental and societal interests. Some have tried to resolve the governance problems result from the separation of ownership and control; others have tried to reconcile expectations of shareholders and other stakeholders. Observers are impressed by the sheer variety of activities — codes of conduct, legislative enactments, political rhetoric, bureaucratic initiatives, etc. — that have surfaced, propelled first and foremost perhaps by well-intentioned politicians who claimed to be reformers. The impacts of these policies on the economic restructuring, political institutionalization and legislation, however, were by no means clear. Indeed, it has been seven years since the financial crisis swept through the region; since then, efforts undertaken and corporate governance structures have substantially improved in the corporate governance of several ASEAN member countries. While genuine and substantive reforms have been made in this respect, the path to further reforms continues to be arduous.

It is in this spirit that the Institute of Southeast Asian Studies (ISEAS) in Singapore initiated a research project in “Reforming Corporate Governance in Southeast Asia”. Renowned scholars from various disciplines of business administration, economics, law, political science and public policy and business practitioners from the Southeast Asian states were invited to review and critically examine the corporate governance reform experiences of each country, and to present their arguments and evidence in the ASEAN Roundtable 2004. The result was a vigorous discussion and an exchange of a wide range of arguments and ideas among the participants. After substantial revision of the drafts, we are now able to present these ideas in the present volume.

Organization of the Book

In Chapter 1, entitled “Corporate Governance — An Alternative Model”, Madhav Mehra provides a global view of corporate governance issues and

argues for an alternative model that would eventually take off in a complex capitalist economy. Mehra opens the discussion by noting some major positive changes of the corporate world, especially at the board level. On the market front, however, the pictures of reform look grimmer. Scandals in *Enron*, *Anderson*, *WorldCom*, *Parmalat*, *Scandia*, *Vivendi*, *Equitable Life*, *Computer Associates*, *Abold* and *Shell* should be instructive. Mehra also noted that in the recent years, ASEAN member countries have taken great pains and commitments to enhance corporate governance structures. His contention is that ASEAN countries ought to draw lessons from the many corporate scandals in the last decade in the developed countries so as to better reform their corporate sectors. Raising public awareness about the importance of corporate governance is certainly a task that demands the focus of these governments.

In Chapter 2, entitled “Political Institutions and Corporate Governance Reforms in Southeast Asia”, Wu Xun, discusses the complementarities between political institutions and corporate governance to explain the rigidities in corporate governance. Although corporate governance reforms have been initiated at varying degrees in the ASEAN states, real progress has been slow. Therefore, it would be difficult to envisage a convergence of corporate governance practice in the region *vis-à-vis* other regions, partly because of differences in culture, legal tradition, and history and path dependence. Other issues raised by Wu include peculiarities found in the corporate sectors of most ASEAN member countries: high proportion of ownership concentration, which permeated pyramiding and cross-holding to enhance control; high concentration of insider ownership; the power of family conglomerates and government dominance; close links between control and management; exploitation of minority shareholders; and last but not least, rogue politics and corruptions. He warned that ASEAN governments ignore the relationships between political institutions and corporate governance at their own perils.

In Chapter 3, “Disclosure, Reporting and Derivative Actions: Empowering Shareholders in Southeast Asia”, Low Chee Keong discusses the merits and demerits of quarterly reporting and statutory derivative actions. He argues that the existing problems are too pervasive and complex for these processes to address adequately. Indeed, good corporate governance has to encompass solutions including the observation of credible corporate transparency and accountability. The encouragement of shareholder activism and vigorous response is an idea that corporate stakeholders should entertain. As a legal specialist, Low identifies the inherent limitation of minority shareholders’ rights to derivative action at both common law and statutory against the

majority shareholder. The introduction of class action to corporate law litigation is another solution to the problem.

In Chapter 4, “Governance Reforms in the Banking Sector in Southeast Asia: Economics and Institutional Imperatives”, Dipinder S. Randhawa addresses the much neglected issue of banking reform in the corporate governance literature with specific reference to several ASEAN member countries on and after the financial crisis in 1997. He makes several critical observations on the inherent opacity in the Southeast Asian banking sector. While the recovery from the financial crisis has been impressive, there are still many hurdles ahead where building a sound and viable banking sector is concerned. Such hurdles would include under-developed financial markets, inadequate financial regulation and lack of policy coordination. Development of capital markets and contractual savings institutions is an overriding priority for Asian economies in the coming decades.

The chapters on the individual countries in ASEAN are empirical case studies which detail the reform experiences, lessons learnt, important issues and challenges that continue to confront policymakers in these states.

By focusing on the Malaysian corporate governance reform experience from different perspectives, Cheah Kooi Guan and Philip Koh Tong Ngee seem to advocate for more urgent steps to be taken in the direction of an institutional development of international organization. In Chapter 5, “Corporate Governance Reforms in Malaysia: Issues and Challenges”, Cheah argues that the Malaysian corporate sector has been characterized by a high concentration of ownership (family or government) with significant participation of owners in management. Malaysia has undertaken significant corporate governance reforms, particularly in the aftermath of the Asian financial crisis (1997). Indeed, the amendments to various corporate statutes since 1997 have considerably strengthened the corporate governance regulatory framework, provided the authorities with the necessary powers to enforce the laws relating to corporate governance, and served to act as deterrents to potential abuses.

In Chapter 6, “Corporate Governance in Malaysia: Some Aspects of Reforms and Institutional Constraints in Light of Post-1998 Crisis”, Koh takes the position that Malaysia’s current implementation and enforcement of corporate governance laws and regulations are not entirely satisfactory. The politicization of regulatory bodies and relatively weak judiciary seem to be major reasons for such an outcome. Most importantly, apart from regulatory concern, other social and cultural norms (such as the prevailing Bumiputera affirmative action policy) would also continue to significantly influence the form and substance of corporate governance structure.

Like other Southeast Asian countries, Indonesia has also undertaken a sizeable amount of corporate governance reformatory works in the last seven years. Djisman S. Simanjuntak's chapter (Chapter 7, "Indonesia's Tolerated Low-Speed Reform of Corporate Governance") describes these reforms efforts, which include amendments and modifications to the Company Law, Capital Market Law and Bankruptcy Law. Accordingly, it appears that accountability and transparency have been enhanced in the corporate sector through the introduction of independent directors and various independent board committees. However, he is not very optimistic as to the eventual outcome, as there is still a very wide gap between the spirit and letter of governance-related laws and regulation and implementation. The reliance on weak legal protection may not be adequate to bring about significant improvement in the corporate standards.

In Chapter 8, "The Political Economy of Corporate Governance in Indonesia", Andrew Rosser introduces a valuable perspective, that is, the challenges faced by Indonesia as a result of the politicization of the corporate governance in the country. Given the shrewd politicization of Indonesian economy, Rosser argues that any push for credible corporate governance reform should emanate from outside the state pedestal. In this regard, a bottom-up approach is ideal.

The Thai chapters were written by an economist and a legal scholar. In Chapter 9, "Building Good Corporate Governance after the Crisis: The Experience of Thailand", Deunden Nikomborirak provides detailed and up-to-date descriptions of the Thai policymakers' concerted effort to enhance the existing corporate governance structure in the wake of the Asian financial crisis. She argues that high corporate concentration of ownership (family and to a lesser extent the government) has resulted in corporate abuses which, amongst others, include: expropriation and misuse of company's funds by major shareholders; corporate wrongdoings that are legitimate due to certain legal loopholes; connected transactions; and state directed and relational lendings in the banking sector.

In Chapter 10, "National Corporate Governance Committee: Three Disciplines for Good Corporate Governance in Thailand", Saravuth Pitiyasak reviews a three-pronged strategy which Thailand has adopted for reform: regulatory discipline, market discipline and self discipline. Such an approach was combined with policy and institutional frameworks namely, the National Corporate Governance Committee was established in 2002 to inculcate good corporate governance structure in the short-, middle- and long-term bases. He concludes that the National CG Committee has been effective.

Furthermore, it is moving towards the right direction and will eventually bring positive benefits to the Thai capital market as a whole.

The Singapore experience in corporate governance reform may be unique in many ways. In Chapter 11, “State of Corporate Governance Reforms in Singapore — Economics Realities, Political Institutions and Regulatory Frameworks”, Kala Anandarajah notes that Singapore’s corporate regulatory framework has moved visibly from merit-based to disclosure-based regime. The promulgation of the recent Code of Governance 2001 brings fresh impetus to corporate governance practice. However, heavy corporate concentration of ownership largely centred on families or governments continue to pose as a sticking point. As government-linked companies (GLCs) have been severely criticized by both domestic and international market players and academics, Ho Khai Leong addresses this issue in Chapter 12, “Corporate Governance Reforms and the Management of the GLCs in Singapore: Pressures, Problems and Paradoxes”. Ho argues that criticisms directed at the GLCs are generally levelled at the outcomes of their success (for example, crowding of the local capitals) as opposed to their failures (corruptions, collusion and nepotism). Arguably, the underlying nuances between the government authorities and the GLCs have never been vigorously questioned, if not, challenged. There is a prevalent perception that the GLCs are not entirely transparent and this has resulted in some degree of economic advantages over other forms of corporate entities. In order to render the Singapore economy more competitive, the state will have to deal with what he calls “paradoxes” which are inherent in reforming the practice and policy of corporate governance.

In Chapter 13, “From the Inside Out: Reforming Corporate Governance in the Philippines by Engaging the Private Sector”, Felipe Alfonso, Branka A. Jikich and Rene G. Banez argue that the Philippines has been suffering from the same malaise of corporate governance in other Southeast Asian countries — opaque financial reporting, conciliatory boards of directors, poor internal controls, haphazard disclosure, and substandard audits etc., as these problems are entrenched in the corporate structure. The years of reform efforts by the Securities and Exchange Commission have yielded limited results. The authors conclude by noting that an internal, sustainable culture of good governance is essential, and that the vigorous enforcement of requirements is much more urgent than rhetorical adaptation of requirements which were ignored.

In Chapter 14, “Corporate Governance of Financial Institutions: The Philippine Case”, Mario Lamberte and Ma. Chelo V. Manlagnit examine the extent to which financial institutions in the Philippines are profit efficient and in so doing, examine the way in which profit efficiency is affected by

three sets of correlates, namely market conditions, corporate governance, and agency costs. Their findings suggest that market conditions, corporate governance and agency costs are important factors in explaining variations in profit efficiencies across financial institutions. They argue that such findings will assist the shareholders, regulators and the general public in monitoring the performance of financial institutions and improving the corporate governance systems of financial institutions in the Philippines.

Nick Freeman's chapter (Chapter 15, "Promoting Good Corporate Governance Practices in Vietnam: A New Element in the Economic Reform Agenda") focuses primarily on the burgeoning private sector in Vietnam and its corporate governance practices. Freeman notes that there is a lack of committed political will at policy level to promulgate comprehensive corporate governance provisions. The prevailing corporate laws, namely the Enterprise Law (currently under review), State Enterprise Law and Foreign Investment Law, are inconsistent and are ambiguous *vis-à-vis* corporate governance principles. This, in turn, reveals a large amount of legal loopholes in the State Enterprise Law and Foreign Investment Law.

In Chapter 16, "Corporate Governance in Vietnam's Equitized Companies: Progressive Policies and Lax Realities", Nguyen Van Thang provides an analysis of current policy and the reality of corporate governance in Vietnamese equitized companies since the introduction of "*Doi Moi*", or "market economy under socialist orientation" in 1986. Although there are existing impediments to the progression of good corporate governance practice in Vietnam, barring any dramatic political setback, the corporate governance structure is poised to improve in the middle to long term.

These introductory paragraphs only touch the surface of the analyses and arguments of these chapters which study the rich nuances of the issues and problems of corporate governance. Beyond an attempt to succinctly summarize these articles, the editor is unable to do justice to these authors' views. It is hoped that this volume will be able to provide policymakers in Southeast Asia with the most current research, ideas and policy options on corporate governance reform, thereby allowing them to be more committed and effective in fostering governance change in the future. Despite a decade of reform effort by the Southeast Asian states, policymakers know there is little ground for gratification and complacency. Undoubtedly, there continues to be a need for the reform of the policy and practice of corporate governance. The ultimate goal, if there is one at all, is to build strong and effective institutions capable of sustaining economic and business performance while maintaining greater accountability and transparency, not only to the shareholders but also to the citizenry in general.

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