Corporate Governance in Asia

Berkeley Center for Law, Business and Economy
May 4, 2006

Hasung Jang
Dean
Korea University Business School
Changes in Corporate Governance in Asian Region

- Convergence in regulations has taken place after 1997 Crisis
  - Globally compatible rules and regulations are introduced after 1997 economic crisis
  - New rules and regulations are intended to
    - Enhance transparency and accountability
    - Strengthen minority shareholders’ right
  - Outside directors and audit committee are required in most of East Asian countries
- Poor corporate governance practices despite improvements in regulations
Corporate Governance Reforms in East Asian Countries, McKinsey Quarterly, 2004

- Outside directors and audit committee are required in most of East Asian countries after the 1997 crisis.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td></td>
<td></td>
<td>2003</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>India</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Indonesia</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Malaysia</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Philippines</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Singapore</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>South Korea</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Taiwan</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Thailand</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Source: Asian Corporate Governance Association
Why poor CG practices despite an improvements in regulations?

• Enforcements of rules and regulations are weak
  - Supervisory agency is inactive
  - Prosecutors are not independent from business influence
  - Judges are not properly trained and not independent

• Shareholders are inactive
  - Local institutions are not independent
    • interest conflict with investment banking business
  - Foreign institutions are not willing to engage
Why Poor Corporate Governance in Asia?

• Bank-financing is stronger than capital market financing, but
  – Banks have its own poor governance problem
  – Bank’s capacity in CG risk management is weak

• Moral hazard of controlling shareholder
  – Family values control more than share value
  – Unfair related party transactions

• Entrenched ownership structure
  – Concentrated ownership via pyramidal or circular ownership
  – Disparity between cash right and voting right
Is Poor Corporate Governance in Asia due to Confucian Culture?

- Partly yes, because
  - Hierarchical culture imposes submission to “order” from high rank
  - Royalty to organization is sometimes more “valued” even if it conflicts with the principle

- But, the final answer is No
  - Confucius teaches “honesty”
  - Confucius never condone “stealing” from others
  - Confucius teaches “transparency” and “accountability”
  - This is true for all cultures and religions
Example of Ownership Structure: Samsung Group

- Samsung group has 63 affiliated companies
- Group is under the control of Lee Family
- Lee family owns less than five percent of shares, but has an ultimate control on all affiliated companies
- The following figure shows complexity of ownership structure that is a mix of circular and pyramidal equity holdings among affiliated companies
  - In figure, companies in red box are public companies. Others are private companies.
Corporate Governance Scoring Project on 9 East Asian Economies
PECC project in 2005 by Stephen Cheung and Hasung Jang

Two surveys
• Survey One: Rules and Regulations on CG
  • Stock-taking exercise by local experts
  • Based on 5 OECD principles
• Survey Two: Market perception on CG practice
  • Questionnaire distributed by Investment Fund Association
  • Fund managers and analysts with investment exposure in the region
Corporate Governance Scoring Project on 9 East Asian Economies
PECC project in 2005 by Stephen Cheung and Hasung Jang

- Two sets of surveys
- Survey One: Regulation on CG
  - Stock-taking exercise by local experts
  - Questionnaires are based on OECD principle
  - 103 questions: 55 for scoring, 48 for confirmation
- Survey Two: Market perception on CG practices
  - Fund managers and analysts with investment exposure in the region
  - 10 questions, 25 responses
Corporate Governance Scoring
Results on 9 East Asian Economies

<table>
<thead>
<tr>
<th>Country</th>
<th>Regulation</th>
<th>Investor Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>0.79</td>
<td>17.03</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.76</td>
<td>19.75</td>
</tr>
<tr>
<td>Korea</td>
<td>0.66</td>
<td>26.11</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>0.66</td>
<td>39.24</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.64</td>
<td>25.25</td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.63</td>
<td>26.26</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.63</td>
<td>17.60</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.63</td>
<td>25.64</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.61</td>
<td>40.18</td>
</tr>
</tbody>
</table>
Corporate Governance Regulations and Investor’s CG Evaluation
9 East Asian Economies PECC project in 2005
CG Scoring Results on 9 East Asian Economies

• Rules and Regulations
  - China and Philippines score the highest
  - Singapore scores the lowest
  - Other countries in the middle are statistically indifferent

• Market Perception on CG Practices
  - Singapore and Hong Kong are in the high group
  - China, Indonesia and Philippines are in the low group
  - Rest of countries in the middle group are statistically indifferent
CG Scoring Results on 9 East Asian Economies

- Rules are Regulations are fairly the same
- Practices, however, are quite different
- Significant disparity between rules and practices
  - Countries with more rules and regulations have good practices: China and Philippines
  - Countries with less rules and regulations have good practices: Singapore, Hong Kong

- Implications
  - Causality: Countries with poor practices introduced more regulations
  - Without proper enforcements, rules and regulation does not mean much
What Will Expedite Improvement in Corporate Governance?

• Government
  - Effective enforcement of regulations
• Legal System
  - Fair and effective court system
  - Fair and independent prosecution
• Corporation
  - Adaptation of global standard
• Market
  - Pro-active role of institutional investors
  - Shareholders exercise its rights
Alternative Approaches in Korea

• Shareholder Activism
  - NGO minority shareholder activists since 1997
  - Group of two dozens volunteer professionals

• Corporate Governance Fund
  - Korea Corporate Governance Fund
  - To be established in Spring of 2006 with US$300 million
  - Investment Objective is enhancing share value by improving CG
Apology for not being present.

Thank you!