

**Corporate Governance in Asian countries:  
Comparison, analysis, and recommendation  
Towards a unified Code of Best Practice**

**By**

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## **Executive Summary**

1. This study provides a summary of the state of development of corporate governance structures in some Asian countries in the Asia-Pacific region. The focus of analysis in the reports is on governance of publicly traded companies in these economies.
2. Since the early 1990's, corporate governance has been receiving increasing attention from regulatory bodies and practitioners worldwide. In 1999, the Organization for Economic Co-operation and Development (OECD) adopted a set of principles of corporate governance. This set of principles forms the basis of setting corporate governance practices in developed countries.
3. The body of study on corporate governance generally notes that while the common goal of good governance practices is universal, the specific set of codes of practice in each individual countries should be modified to suit the local circumstances, such as culture, the legal system, and institutional setting of capital markets. A code of practice is meaningful only if it is consistent with the local economic system, accepted and adopted by corporations, and applicable in their practices.
4. The goal of this study is to provide a basis for the development of a set of codes of practice for Asian countries. In the report we lay out the profile of the constituent systems under which corporate governance should be developed and implemented. These features are contrasted with the corresponding elements in developed countries. The conclusion from this contrast suggests that in Asia economies the OCED principles should not be copied at the face value.

5. Our study also reviews that most Asian countries have taken steps to establishing principles in accordance with the OECD standard.
6. We note that a significant difference of corporate governance guidelines between the developed countries and Asian countries is in the main goals in the code of practice. In the developed countries capital markets are typically characterized by large corporations with significant institutional ownership. Such a setting provides a complex agency framework in which institutional investors (agent for fund investors) seek for assurance of proper responsibility from the corporate managers and directors (agent for shareholders). From the early 1990's corporate governance has been focusing on aspects of such a setting. In particular, significant attention is placed on the issues such as the rights of the shareholder, compensation policies of corporate managers, and the responsibilities of the board.
7. In Asian countries, institutional investors typically play a minor role in local equity markets. The relevant agency framework is between corporate insiders (or large shareholders) and arms-length minority shareholders. Special attention is placed on the means of protecting minority shareholders and foreign investors who do not have deep enough understanding of local market factors and corporations. Key issues include disclosure and transparency and equitable treatment of shareholders.
8. The cornerstone of OECD corporate governance principles lies in the enhancement of shareholder value, i.e., corporate governance practices are incorporated with a sole objective of providing a higher return to shareholders. In Asian countries, we note that in some member countries issues other than shareholder value are addressed. Such issues include the role and protection of other non-shareholder stakeholders of the firm and social responsibility. At the current stage, such non-shareholder value issues are not uniformly recognized and adopted in the code of practice in individual countries.

9. A key aspect of improving corporate governance in Asian countries is that improved investor protection and more transparent information enhance the development of local capital markets and promote foreign investors to provide funds for economic development. We suggest these two elements as the high priority targets for governments and regulators in formulating the relevant set of governance systems in the local economy.
10. Investor protection has its foundation in the legal system and the regulatory environment of the specific economy. In Asian economies we note that there is a fairly diverse set of legal and regulatory environments. This feature is a main contributing element to the difficulty in devising a common set of codes of practice in the near future.
11. Another key issue in Asian countries concerns the ownership structure of listing corporations. The “standard model” of a listed corporation in the OCED setting is one that the management and the ownership of the firm are separate. Typically large corporations in the developed countries have the key officers holdings a small portion of common equity. In Asian countries ownership is much more concentrated, and large shareholders often hold executive or directorship positions in the company. Efforts need to be made to address this unique feature in Asian countries. Our analysis is that concentrated ownership provides a setting in which not all the principles of the OECD governance principles become valid. This unique ownership profile also presents additional challenges pertinent to firm value and the welfare of shareholders.
12. Our recommendations contain short-, medium-, and long-term objectives. The principle of our framework is that individual countries should first focus on improving the standard of regulation and practices rather than jumping to try to reach a common set of metrics from the start. When governance standards are in place and reasonably adopted by corporations, the sets of governance codes of

practice would then be integrated into a framework of consistent common code of practices for all Asian countries.

13. It should be noted, however, that efforts to promote the short-, medium-, and long-term objectives could and should be done in the same time. Typically, shorter-term objectives are associated with more easily defined benchmarks for the measurement of objective accomplishment and involve a more specific group of participants (such as the accounting professions), whereas longer-term objectives require continual interactions and involve a boarder level of participation.
14. The short-term targets address the issues of legal, regulatory, and accounting systems. We propose that investor protection and efficiency in information disclosure are the key objectives and would form a firm foundation of corporate governance.
15. The medium-term targets address the adoption of codes of practice in listed corporations. We note that corporate governance involves both quantitative and qualitative components, and that simply satisfying the required minimal standard might not lead to significant enhancement of investor confidence. The key issue is that good governance involves a high degree of voluntary participation from corporate directors and executives.
16. Long-term goals that involve the convergence of the individual country codes of practice into a common integrated set of codes of practice for all Asian countries. Such efforts involve the understanding of the importance of good corporate governance practices in all member countries and also a good understanding of specific issues faced with in specific countries. Continual efforts that include high-level interactions of regulators, board members, and the investment community are important to ensure that the long-term goals can be achieved.

## **Background**

17. Corporate governance refers to the system through which the behavior of a company is monitored and controlled. The basis of the significance of corporate governance is that in modern economies large corporations are typically associated with a division of labor between the parties who provide the capital (i.e., shareholders) and the parties who manage the resources (i.e., executives). Conflict of interest among the various groups of the company might lead to insufficient monitoring of the executive managers, sub-optimal investment of firm, or some shareholders being expropriated. In these scenarios shareholders might be hurt if there are not sufficient means to ensure that the company is properly monitored.
  
18. Interests in corporate governance by policy makers in developed countries had grown significantly in the early 1990's. Three issues were addressed and studied following a general concern on the overall efficiency of the corporate world. First, did corporate directors and managers receive clear allocation of responsibilities and were monitored in an appropriate manner? Second, did the accounting profession deliver the useful set of information for investors so that investment decisions could be made in an efficient way? Third, how was compensation of corporate executives and directors determined in view of the concern that executives were being pay higher and higher compensation packages, some amidst significant decline in firm performance?
  
19. The first large-scale official efforts in the OCED countries resulted in the publication of the Cadbury Report (1992) in the United Kingdom. The objective of the Cadbury committee was to investigate how large public companies could adopt corporate governance guidelines with a focus on the procedure of financial report production and the role of the accounting profession. Issues include role of the board of directors, standards of financial reporting, accountability of auditors, and directors' pay.

20. A follow-on study was carried out in the United Kingdom and the Greenbury Report (1995) was released to address in more detail the remuneration of executives and non-executive board members. The report recommended the setting up of a remuneration committee in each public company to determine the remuneration packages for the board members. It also provided suggestions on the disclosure of remuneration, and the setting up of remuneration policy and service contracts and compensation.
21. Another major effort resulted in the Hampel Report (1998) in the United Kingdom that supposedly served as a concluding study on the issues raised by the Cadbury and Greenbury reports. Four major issues were discussed with practical guidelines offered: (1) the role of directors; (2) directors' compensation; (3) the role of shareholders; and (4) accountability and audit.
22. Separate efforts were made in other OCED countries that address similar issues as in the various studies carried out in the United Kingdom. In general, these efforts address the notions that decision made by the directors and executives of a public company should be consistent with the interest of shareholders, and that investors, especially professional institutional investors, should receive adequate, accurate, and timely information concerning the value of the firm.
23. The foundation of corporate governance concerns lies in the ownership structure of firms listed in OCED stock exchanges and the institutional setting of these capital markets. Typically, there is a clear separation between ownership and control in these companies. Directors and key executives, while responsible for the investment and other corporate decisions of the company, are acting as an "agent" for the shareholders of the company rather than as a "principal". Furthermore, directors and officers as a group usually hold a small portion of the equity of the company. Studies carried out in the United States suggest that such "corporate insiders" hold on average of about 5% of shares of the company. It is

not clear how these parties will make decision consistent with the interest of shareholders as a whole.

24. OECD listed companies are also characterized by a significant ownership by institutional investors. The online corporate governance resource center [corp.gov.net](http://corp.gov.net) states that institutional investors hold about one half of all listed corporate stock in the United States and about 60% in the largest 1,000 corporations. In capital markets outside the United States, the top 25 U.S. pension funds account for 42% of the foreign equity held by all U.S. investors <sup>1</sup>.
25. Table 1 provides more international data of institutional holding of equity. The Table shows that for the period 1990-91, the holdings by institutional investors, as defined by financial institutions including banks, insurance companies, pension funds, and investment companies, are, respectively, 40% in the United States, 61% in the United Kingdom, 20% in Germany, and 47% in Japan.
26. Pension funds represent the most significant group of institutional investors. In the United States pension funds represent 25% of all equity. This figure is 30% in the United Kingdom. In Germany and Japan, insurance companies represent a large group of institutional investors, representing 11% and 17% of all equity.
27. These figures suggest that to a significant degree, the ownership structure of corporations in OECD countries is driven by the adoption of universal pension benefit programs such as ERISA in the United States <sup>2</sup>.
28. The active involvement of institutional investors implies that fund managers (who are agents of fund beneficiaries) demand metrics through which they can use to make their investment decisions, and an assurance of proper monitoring of public companies <sup>3</sup>.

29. The globalization of capital markets presents a trend in the pursuit for a common set of policy guidelines and codes of practice. On a high level, policy makers are more and more aware of the benefits of good governance. For the investment community, institutional investors present a dominant force in making portfolio investment decisions outside the home country.
  
30. The OECD Council called upon the OECD to develop a set of corporate governance standards and guidelines and published in May 1999 a common set of guiding principles on Corporate Governance for all OECD member countries. This set of guidelines forms the standard for individual governments, regulatory bodies, and professional bodies to develop their action items and with a view to set up an acceptable set of codes of practice.

## **OECD Principles and International Standards**

### **A. OECD Principles**

31. The OECD Principles covers five aspects of governance: (1) the rights of shareholders; (2) the equitable treatment of shareholders; (3) the role of stakeholders in corporate governance; (4) disclosure and transparency; and (5) the responsibilities of the board. Table 2 provides a summary of the main issues in each of these five areas.

#### ***A.1 The rights of shareholders***

32. Six points were covered with respect to the rights to shareholders. Such points cover the issues concerning the property right, transfer of such right, and the exercise of the right in activities such as voting on proposals set forth by the board. Also, the OECD recognizes the markets for corporate control as a potentially effective means of remedy should shareholder rights be violated.

#### ***A.2 The equitable treatment of shareholders***

33. The general rule is “one share, one vote”. In the event that the equity of a company consists of more than one class of shares, holders in each class should be treated in an equitable and fair manner. Also, board members and managers should disclose material holding in the company, or transactions or matters affecting the corporation.

#### ***A.3 The role of stakeholders in corporate governance***

34. This rule recognizes that there are other stakeholders other than shareholders in a common. The spirit of the guideline is to encourage active co-operations of the stakeholders. Such co-operation will contribute to the creation of wealth, jobs, and sustainable financial strength of the company.

#### ***A.4 Disclosure and transparency***

35. Under this principle, the corporate governance framework should provide assurance that accurate information of all material matter be disclosed to investors.

Independent audit should be incorporated in the production and disclosure of information.

***A.5 The responsibilities of the board***

36. The board is the ultimate authority to devise, review, and monitor the execution of the strategic plans of the company that defines its success. This guideline spells out the board's responsibilities to act in an informed, diligent, and objective manner. There is a suggestion in the area of board composition, which states that board members should include a sufficient number of non-executive members to ensure independent judgment.
  
37. Similar to other documents of corporate governance, the OECD Principles may be translated into codes of practice that include both quantitative measures (such as frequency of independent audits and number of independent non-executive board members) and qualitative directions (such as the provision of sufficient time and efforts by board members).
  
38. An important aspect in the OCED Principles (as essentially all studies on the subject of corporate governance) is that good corporate governance should fit the specific set of legal, macro-economical, regulatory, and cultural features in each specific country. "There is no single model of good corporate governance. ... The Principles build on these common elements and are formulated to embrace the different models that exist..."<sup>4</sup>

## B. International Standards – Western countries

39. There are several models that describe the nature of the governance systems in corporations. As stated earlier, such a system is the result of the institutional setting and also the culture that the corporations are operating. One such classification is the Anglo-Saxon model (that applies to the United Kingdom and the United States) and the Rhineland model (that applies to Germany and a few other continental European countries).
40. The Anglo-Saxon model of governance is characterized by widespread shareholding of equity and a stress on financial objective of the companies. A typical company is one that is represented by a large number of shareholders at arms-length (hence the model is sometimes referred to as the “outsider model”). The objective of the governance system is to set up rules and guidelines so board members and executives work to maximize shareholder wealth. Shareholders are viewed as “risk takers” of the company.
41. The Rhineland model is characterized by a significant holding by a parent company and outside shareholders represent a lesser portion of the equity. This model is concerned more on a “socially correct” market economy. In fact, individual companies within a Group can be viewed as an “internal market”, both in terms of financial resources and other resources such as labor and intellectual properties. Hence, co-operation is stressed. Shareholders in this system are generally stable partners and much longer-term investors as compared with the case of the Anglo-Saxon model. Shareholders are viewed as “partners” of the company.
42. The Rhineland model also presents a difference in the structure of the board of directors. German companies comprise of a dual board system: a supervisory board that is responsible for strategic decision making, and a managerial board that is responsible for the execution of the strategies (A similar system is present in the Japanese corporate system).

## **Corporate Governance in some Asian Countries**

### **A. Background**

43. The OECD Principles attempt to act as a common platform from which each individual country starts to build the codes of best practice most suitable for the specific issues faced by the particular country. The OECD also recognizes that corporate governance should be an evolutionary process and be adjusted as new issues emerged in the capital markets.
44. As corporate governance is the product of a complex set of cultural, economic, and social issues and that the governance structures of corporations differ from country to country, it is appropriate that a unique set of corporate governance guidelines and practice codes be designed and adopted for each constituent country. In the end, corporate governance should produce an environment within each country that corporations identify with and adhere to in their decision-making processes.
45. In Asian countries, the interest in corporate governance has been stepped up in the late 1990's. Subsequent to the outbreak of the Asian currency crisis in 1997, the flow of capital from foreign investors had suddenly been dried up, leading to intense liquidity problems in local capital markets and real impact in the economy due to insufficient capital.
46. The promotion of good corporate governance serves two important purposes in the development of local and regional capital markets. First, local equity markets play an important role amidst the lack of foreign capital. Good corporate governance promotes the development of local equity market, and reduces the reliance in foreign debts. Second, institutional investors represent the majority type of foreign investors. Improved corporate governance provides a higher level of investor confidence from international investors, and increases the stability of local equity and other capital markets.

47. There are numerous benefits of good governance are to the Asian corporate setting. The most significant value is the reassurance of investor confidence, especially for foreign institutional investors. In the long run, good governance leads to the stability of local capital markets development since foreign capital becomes more "patient".
  
48. Studies have stressed several factors that contribute to an environment that nurtures good governance: (1) laws that define and protect private property rights; (2) laws that protect and enforce contractual rights, such as contracts between lenders and borrowers; (3) laws that protect against fraud and unfair and deceptive trade practices; (4) centralized banking laws; (5) bankruptcy laws; and (6) a competent, ethical, politically independent judiciary system.
  
49. Other studies suggest that sound corporate governance enhances stable and low cost capital formation. To preserve this benefit, measures taken should include (1) corporate management to prevent fraud, waste, and inefficient use of corporate assets; and (2) disclosure of relevant information using consistent and comparable accounting and auditing standards.

## B. Value of Good Corporate Governance

50. Studies have shown evidence in support of real value of corporate governance to corporations. McKinsey & Company conducted an investor Opinion Survey on a sample of local and foreign institutional investors in 2000 and 2002. The study was carried out to a large group of institutional investors in each of the countries studied to see if the investors were willing to pay a premium on good governance practices and if yes, the magnitude of the premium. Table 3 provides a summary of the key results in the McKinsey study.
51. An overwhelmingly large percentage of the respondents stated that they were willing to pay a premium for companies with good governance structures. In 2000, On average, 83.5% of the investors included in the study were willing to pay a premium for well-governed companies. while 81.0% were willing to pay for a premium for well-governed companies in Europe and 89% in Asia. These numbers provide clear indication for positive value of good corporate governance practice. This benefit of a supposedly higher firm value is even more pronounced in Asia. However, there is sign of improvements that the percentage of investors that were willing to premium for well-governance companies decreased in the 2002 survey.
52. With regard to the magnitudes of premiums that investors are willing to pay, it appears that there is a pattern that the value of good corporate governance is higher for countries that the quantity and quality of information available to investors are relatively inadequate. For example, in 2000, the average premium to OECD countries was 19.2%, compare with the average premium of 24.4% to non OECD-Asian countries. The highest level of premium accrued to Indonesia (27%) and Thailand (26%), both countries being heavily affected by the withdrawal of foreign investment capital during the Asian currency crisis of the late 1990's.
53. In 2002, the average premium to OECD countries was 14.6, compare with the average premium of 21.2% to non OECD-Asian countries. We observed that

there was some improvements made in the both OECD and non-OECD countries in Asia on the average premiums of those investors willing to pay. The highest level of premium still accrued to Indonesia (25%) and Malaysia (22%). The premium for Thailand declined to 20%.

### C. Convergence and divergence of Asian codes

54. Given the common awareness and recognition of the benefits of sound corporate governance, there exists a host of factors that stimulates the convergence of corporate governance codes with international standards.

55. A set of factors is suggested by the literature to affect the convergence of governance:

- Enhancing shareholder value as *the* or *a* primary focus of companies
- The need for non-executive and independent non-executive directors to provide an “outside” view on strategic direction.
- The usefulness of board committees responsible for audit, nomination and compensation and comprising a majority of independent directors.
- The importance of higher levels of information disclosure from listed companies
- Allowing or encouraging institutional investors to act as a check against management

56. A specific example of convergence in governance standards in Asia is the development of audit committees. The series of events can be summarized as follows:

- 1989 - Singapore mandated the adoption of audit committees following the collapse of a major conglomerate and a market crisis in the mid-1980s
- 1994 - Malaysia followed suit
- 1998 - Thailand announced that all listed companies must form audit committees by December 1999
- 1999 - Korea also made audit committees mandatory for the listed subsidiaries of the top 30 conglomerates

57. There are other examples of divergence, including:
- The “stakeholder” concept. Some countries (China, Korea, Japan and Thailand) adopt the concept of stakeholders in their governance principles, whereas Singapore and Malaysia stress the social importance of corporations, but do not emphasize stakeholders in the governance context
  - Board structure: Some countries have single-tier, and some have two-tier boards. Most countries have the former. Thailand is alone in considering moving from single-tier to two-tier different regulatory or legal styles.
  - Different legal systems. Hong Kong, Malaysia and Singapore have Anglo-Saxon legal systems, whereas other countries have a variety of roots in their legal systems.
  - Scope of a country’s practice code. Both Hong Kong and Singapore have small codes that are limited in scope. Hong Kong’s code is about a page and a half long and is extremely general. Singapore’s current code is at similar length and only focuses on audit committees. At the other end of the scale is the new code from Korea, which runs to about 40 pages and covers each aspect of governance comprehensively.

## D. Characteristics of Asian capital markets

58. In many aspects, Asian equity markets are very different from major equity markets in western countries. An obvious example is that except for Japan, all stock markets in the Asia are emerging markets. Characteristics include smaller capitalization, smaller size of capital raised, relatively infrequent turnover, and a concentration of ownership.

### *D.1 Market capitalization*

59. Table 4 presents summary information for market capitalization of seven major stock exchanges OECD countries (including Japan) and ten “emerging” stock exchanges in Asian economies. The data are taken from the database of the International Federation of Stock Exchanges, which is a federation of 49 stock exchanges worldwide. As of the end of 2002, the “world capitalization” of all 49 exchanges was US\$ 23 trillion.

60. The largest two stock exchanges as at 2002 were the New York Stock Exchange (NYSE) and the Tokyo Stock Exchange, representing capitalization of US\$ 9.0 and US\$ 2.1 trillion, respectively. Taken together, the NYSE and the Tokyo Stock Exchange account for US\$ 11.1 trillion total capitalization, or 48.6% of the world capitalization. The combined capitalization of NYSE, NASDAQ, Tokyo, London, Paris, Euronext, and Toronto was US\$ 17.7 trillion, or 77.5% of the world capitalization.

61. Within the set of Asian (plus Australia) stock exchanges, Hong Kong was the largest with a capitalization of US\$ 463 billion, followed by Australia (\$ 380 billion). Other relatively larger exchanges were Taiwan (\$ 261 billion), Korea (\$ 216 billion), and Kuala Lumpur (\$ 123 billion). Taken together, the ten Asian exchanges account for US\$ 1,160 billion, which is less than the size of the London Stock Exchange.

## ***D.2 Capital raised***

62. Table 5 presents information on the amount of funds raised in stock exchanges in some selected countries in years 2001 and 2002. It should be noted that the year 1999 was an exceptionally good year for telecom, media, and technology (TMT) stocks, and a significant part of equity raising worldwide was related to TMT companies.
63. Overall, the year 2002 had seen a decrease in equity raising activities. The world portfolio (FIBV total) saw a 21.75% decrease in capital raise. The seven stock exchanges in OCED member countries (NYSE, NASDAQ, Tokyo, London, Paris, Euronext, and Toronto) experienced a 40.36% decrease in capital raised, whereas the eleven Asian stock exchanges (excluding Japan) experienced a 76.5% increase.
64. As a percentage of total capital raised, the OECD exchanges played a very substantial role in 2002. Total capital raised in the seven OECD exchanges totaled US\$ 153 billion, representing 58.3% of the world total. This proportion had shown significant decrease from the previous year, in which the seven exchanges raised 76.5% of all capital raised.
65. The Asian exchanges also showed significant increase in capital raised. Total capital raised in 2002 was US\$ 42 billion, representing 16.2% of the world total. This was also a significant improvement from 2001 in which the same group of exchanges raised 8.0% of the total capital raised in all exchanges.
66. NYSE and Euronext both showed decreases in capital raised. In 2002 a total of US\$ 46 billion (or 17.7% of capital raised globally) was raised in NYSE, and a total of US\$ 34 billion (or 13.0% of capital raised globally) was raised in Euronext. It should be noted that more than 60% of the funds raised in NYSE was raised by newly listed firms in the form of initial public offerings (IPOs), while a majority of the funds raised in Euronext was raised by already listed firms.

67. In Asian countries, the most significant increase was in the Philippines Stock Exchange, with total equity raised of US\$ 786 million from US\$ 143 million in 2001. This increase, however, was mainly attributable to the sharp decline in capital raised by Indonesian companies during the Asian currency crisis. Other than Philippines Stock Exchange, more significant growth in capital raised were found in the Kuala Lumpur Stock Exchange (379%) and the Colombo Stock Exchange (361%). On the other hand, the Thailand Stock Exchange showed a decline in the capital raised.
68. Data presented in Table 5 suggest the weak capital raising capabilities in Asian stock exchanges. While 1999 was a banner year for stocks, it appeared that the larger stock exchanges and the ones with more TMT related companies (which were hot during 1999) received the majority of the benefits in capital raising capabilities. A significant number of Asian member countries still lacks such capabilities.

### ***D.3 Significance of the stock market***

69. Table 6 provides a summary on the importance of national stock markets in 2001 measured by the percentage of stock market capitalization as a percentage of GDP using data from the IMF database. This indicator shows the significance of the finance sector as represented by the stock market in the provision of funding for corporate development. The general rule is the higher is the percentage of the stock market capitalization to GDP, the larger is the share of the stock market in representing the general economy in the country.
70. The sample of six OECD stock markets had a high percentage of the stock market to GDP ratio of 97.9%. The highest ratios were in the United Kingdom (152.2%) and the United States (137.1 %). The countries that had lower ratios include Germany (58.1%) and Japan (55.4%).

71. For the sample of eleven Asian member countries, the stock market capitalization to GDP ratio was significantly lower. The average ratio for the eleven countries was 85.7%. The countries with the highest ratio were, respectively, Hong Kong (312.8%), Singapore (137%), Malaysia (135.1%), and Australia (105%)<sup>5</sup>. The countries with the lowest ratios were, respectively, Sri Lanka (8.5%), Indonesia (17.5%), and Thailand (31.3%).
72. A brief conclusion drawn from the figures in Table 6 is that OECD member countries are general characterized by underdevelopment in capital markets. This property is the case even for Japan, which represents the second largest national stock market (after the United States, as indicated in Table 4) in the world. The stock market in Japan was a relatively small representation of the size of the national economy, and it was basically a closed market until the late 1980's.
73. The other emerging markets in Asia show the similar pattern of underdevelopment in capital markets. In general, corporate governance develops hand in hand with the capital market systems. With relatively underdeveloped capital markets, these member countries will be faced with additional issues in designing and enforcing the appropriate corporate governance rules.

#### ***D.4 Stock Turnover***

74. Table 7 reports the stock turnover on the stocks of domestic companies and foreign companies in seven OECD stock exchanges and ten Asian stock exchanges in 2001 and 2002. In 2002, total turnover for this sample was measured at US\$ 28.3 trillion, compared with US\$ 32.9 trillion in 2001, showing a 14% increase. The rate of turnover decrease in the OECD exchanges (6.4%) was comparable to the increase in the Asian exchanges (4.4%).
75. The stock turnover in OECD stock exchanges represented 88% of turnover for domestic companies in 2002. The same ratio was 87.1% in 2001. That is, approximately 12% of shares accrue to foreign companies listed on these

- exchanges. The most international stock exchange was the London Stock Exchange, which had 52.8 % of all turnovers from foreign companies in 2002 (59% in 2001). The other exchanges with a higher representation of foreign companies include Germany (8.4%) and NYSE (6.9%).
76. Asian exchanges, on the other hand, are mostly domestic exchanges. The only exception was New Zealand with 14.4% of turnover accrued to foreign companies. All other exchanges have less than 2% of turnover in foreign companies. As a group, the ratio of turnover in domestic companies was both 99.6% in 2002 and 2001.
77. Two points are noteworthy. First, most of stock turnover is in the largest OECD stock exchanges. The sample of OECD exchanges accounted for a combined turnover of US\$ 26.5 trillion, or 93.6% of all turnovers. This percentage was 95.5% in 2001. NYSE and NASDAQ, the largest stock exchanges, together accounted for a turnover of US\$ 17.4 trillion or 61.4% of all turnovers. Asian stock exchanges, on the other hand, accounted for a total of 6.4% of all turnovers.
78. A significant number of these investors can be referred to as “day traders”. Typically these investors made their investment decisions not on company fundamentals but on the dynamics of the stock market index or individual stock prices. The implication of the rise of day traders was that a larger portion of the investment community pays little attention to the actual investment value of the underlying company. It is unlikely that these investors would pay much attention to the detail of the governance of the companies.
79. The generalization we can draw from the turnover behavior is that when short-term stock market performance is good, more investors tend to focus on issues related to investor psychology rather than company fundamentals. The other side of the coin is that when the stock market is behaving poorly, the stock exchanges (which are an integral part of promoting corporate governance) will be resources

constrained as their income is mainly derived from the volume of stock turnover. As far as corporate governance is concerned, the objective is to set a long-term goal, which is independent from fluctuations in the stock market.

#### ***D. 5 Market Depth***

80. Market depth refers to the level of liquidity in a stock market and the possibility that a significant block of shares can be sold with a mild impact on the stock price.
  
81. Market depth is especially significant for foreign investors, who are characterized by: (1) a general lack of knowledge in local, social, political, and cultural factors that might have an impact of the stock market; (2) dominated by institutional investors that rely heavily on indirect research materials from their brokers; and (3) generally have substantial holdings of equity that might suffer significant losses in the event of a market-wide on their portfolio holdings.
  
82. Tables 7 and 8 provide some insight on the degree of market depth for various OECD and Asian stock markets. Table 7 reports turnover value by local and foreign investors in 2001 and 2002. Table 8 reports the average amount traded per day, average number of transactions, and average value of transaction in these markets.
  
83. Table 7 reports that in 2002 the sample of OECD stock exchanges have a total turnover of US\$ 26.5 trillion, or 93.58% of all turnover in the exchanges represented in the Table. Among these figures, an average of 12% of turnover was in the stocks of foreign companies (i.e., listed companies from a country other than the country of the stock exchange). The London Stock Exchange was the most international exchanges. With US\$ 2.1 trillion or 52.8% of turnover in foreign companies. Japan was the least international market with turnover in foreign companies representing US\$ 518 million or a mere 0.03% of turnover.

84. In the Asian stock markets, total turnover in foreign companies were US\$ 6.6 billion, representing 0.3% of total turnover. Only New Zealand had a significant portion of turnover in foreign companies. In 2002, 14.4% of turnover in the New Zealand Stock Exchange was in foreign companies, compared with 13.3% in 1998. All other exchanges have a percentage close to or less than 2%.
85. Table 8 shows that stock trading has increased significantly in 2002, both in total value and number of transactions. Number of transactions increased by 36.8% in OECD exchanges and 15.3% in Asian exchanges.
86. NASDAQ was the most active stock exchange by number of transaction in 2002. Total number of transaction averaged 2,379,180 transactions per day, representing a -2.3% increase than the figure in 2001. Average value per transaction was US\$ 12,100, or a decrease of 33.1% than the figure in 2001.
87. The London Stock Exchange showed the largest average size of transaction. Average transaction value in London was US\$ 104,600 in 2002 and US\$ 138,400 in 2001, indicating the unique feature of London as a focus of institutional investors.
88. In the Asian exchanges, most exchanges showed a significant increase in total trading volume and also number of transaction. However, most exchanges represented a fairly consistent pattern of small average value per transaction. For example, Jakarta showed the most significant increase in stock trading. The figures for average value per transaction were US\$ 4,200 in 2002 and US\$ 2,600 in 2001, respectively.
89. The exceptions to the rule of small transaction size included the Osaka Stock Exchange (with an average transaction size of US\$ 27,800 in 2002) and the Australian Stock Exchange (with an average transaction size of US\$ 21,000 in 2001).

90. Overall, the Asian stock exchanges are characterized by low market depth and small transaction size. These features are also related to the dominance of small individual investors. For example, Korea (with 788,700 transaction per day) and Taiwan (with 690,540 transactions per day) were both heavily represented by local individual investors.
  
91. Experience has shown that markets, which are heavily represented by individual investors, are often associated with a lack of interest in corporate governance. In general, individual investors are less informed than institutional investors, and do not intend to participate in governance activities such as voting in determining corporate matter.

## E. Issues in Corporate Governance in Asia

### *E.1 Regulatory system of stock markets*

92. Table 9 provides a summary of the regulatory bodies and clearing settlement organization in OECD and Asian stock markets. The institutional set up of the regulatory bodies and the clearing settlement provide the framework in which stock trading takes place.
93. Many Asian countries had established their respective regulatory bodies for their stock market. In addition, many countries had passed a number of laws with respect to the operation of the capital markets.
94. The emphasis of setting up the regulatory bodies and passing the law has been facilitating stock trading in the local market. However, such institutional settings have usually focused on the mechanism of stock trading, and might put lesser attention to corporate governance issues such as investor protection.

### *E.2 Family ownership*

95. Unlike the OECD model of diverse ownership and separation of the board (led by the Chairman) and the management (represented by the Chief Executive Officer), Asian listed firms exhibit a clear pattern of concentration of ownership and convergence of major shareholding and management.
96. It is conceivable that a number of corporate governance issues in the western model does not apply fully in the setting of concentrated ownership. For example, the issue of board composition (such as number of independent non-executive directors) might not necessarily provide a strong check-and-balance between the interest of the major shareholder and that of the minority shareholders. Since all directors are proposed by the controlling major shareholders, it is unlikely that the number of non-executive directors provides monitoring of the majority shareholders and exerts strong influence on major corporate decisions. The role of such non-executive directors, however, may serve an advisory role in the decision process.

97. Another issue concerns executive compensation in closely held companies. The standard argument in the executive compensation literature has a setting in which the management team (in particular the Chief Executive Officer) holds a negligible stake in the equity<sup>6</sup>. In the event that the controlling shareholders own a significant block of the equity and also hold major executive positions, the majority shareholders/managers bear a larger share of the cost of potentially excessive compensation and lack of monitoring.
98. The difference in the ownership structure has the implication that executive compensation might not be as significant as in the case in OECD companies. For example, the major shareholder/manager who singly owns 51% of the equity will have to bear 51% of the wealth effects of corporate decisions. The implication on their personal wealth on excessive compensation and other sub-optimal corporate decision will be much more intense than the typical CEO in OECD companies who owns a much smaller share of equity.
99. Table 10 summarizes a study on a sample of 1,740 Asian listed companies carried out by *Asia Finance*. This sample covers approximately 78% of companies in the countries studied in terms of market share. The study defines a company as “family owned” if the percentage of equity owned by the members of a family exceeds 20%<sup>7</sup>.
100. Table 10 shows that approximately 58.0% of all Asian companies (by market capitalization) can be classified by being family-owned. The profile of family ownership is fairly consistent throughout the various countries and economies. Malaysia and Hong Kong show the highest degree of family ownership, with 67.2% and 66.7% of total market capitalization controlled by family groups. The lowest level of family ownership is in the Philippines with 44.6% of market capitalization owned by family groups<sup>8</sup>.

101. Table 10 also reports the market value of companies controlled by the top 5 families and top 10 families. The top 5 families control an average 27.9% and the top 10 families control 35.6% of market value, respectively. The Philippines show the highest level of controlling by the top 5 families with 42.8%. Compared with the total family controlling of 44.6%, the figures show that a very large percentage of the stock market capitalization in the Philippines is in fact controlled by the largest 5 families. The lowest level of controlling in the top 5 families is in Taiwan with 14.5% under family ownership.
102. Studies in Asian corporate ownership have indicated that whether the controlling owner is the first generation might play a significant role in corporate governance issues. In general, the first generation majority shareholder/manager is more likely to show a high degree of entrepreneurship and risk tolerance. Since the majority shareholder bears a significant portion of the wealth consequence, his/her interests would be better aligned with the overall value-maximizing objective of the company.
103. In the event that the controlling family members are the second or the third generation of the family, controlling of the shares is conceivably more diverse among the various family members. This feature may lead to a number of outcomes. Either the second (or third) generation members are more well educated and professionally trained to further developed the company into a more international oriented scope, or the members might take a lesser effort to manage the company and attempt to derive a bigger compensation package. The studies in these intricate issues, however, are significantly inadequate.
104. The most significant corporate governance issue caused by the family ownership of Asian corporations is the alignment of interests between the majority shareholder and the minority shareholders. This issue is even more significant given the lack of uniform accounting standards and sufficient disclosure of information.

### ***E.3 State and group ownership***

105. Table 10 also shows information on state ownership of corporations in Asian countries. Traditionally, certain industries (e.g., banking, telecom, etc.) might be heavily regulated and the state may own a controlling stake in the companies in such industries.
106. The figures presented in Table 10 show that Singapore has the highest level of state controlled listed companies with a market value of 23.5%. The second most significant state ownership is in Malaysia with 13.4% of value under state control.
107. When family ownership and state ownership are both included, the Asian stock exchanges represent approximately 70% of market capitalization under family or state ownership.
108. Not presented in Table 10 is state ownership in the Chinese stock exchanges. As of 2001, state controlled companies represent the majority of listed companies in the Shanghai and Shenzhen exchanges.
109. The corporate governance implication of state ownership is that the government might pursue policy objective (such as infrastructure development) that are not necessarily aligned with minority shareholder interest.
110. Another significant issue is group ownership of companies in Japan and Korea. In Japan the *Keiretsu* present a unique closed system of internally monitored corporate setting. This model closely resembled the *Chaebol* in Korea. The group companies are characterized by interlocking cross holding of equity, and outside monitoring is difficult. Until recently, these models had played significant roles in the stock markets in Japan and Korea.

111. Studies had suggested merits and deficiencies of the internal monitoring model of group companies. The major advantage of this model is that the internal system and resources allow the group companies to pursue long-term operating goals and not distorted by the short-run fluctuations in the stock markets. The main drawback, on the other hand, is that there seems to be a lack of monitoring mechanism in case the goal pursued is inconsistent with the economic reality.
112. Traditionally, the *Keiretsu* and the *Chaebol* are keen to pursue market leadership and revenue generating rather than profit maximization. Such objective might not be consistent with minority shareholders' interest when the product market is changing in a way that the specific product market is in decline.

#### ***E.4 Accounting and audit standards***

113. A common problem in information disclosure is the lack of uniformity in the accounting and audit standards among the Asian member countries. Historically, each member country might have its own set of accounting standard. As the accounting system involved both objective and discretionary items, it could be challenging to come up with a common basis of comparison across different countries.
114. The accounting systems of Hong Kong, Malaysia, and Singapore are originated from the accounting system in the United Kingdom. These three economies represent the closest set of accounting standard to investors. Other economies might have a different historical development in their accounting and auditing systems.
115. The relevant issues in disclosure include the quantity of and the quality of information obtained by investors. The objective of accounting disclosure is to provide investors with an adequate set of information to make investment decisions. One potential problem is that firm may only disclose aggregate profits figures, which do not indicate how the net profits are arrived at. This problem is

more significant for conglomerates that have investments in more than one sector. Investors may have no clue on the relative performance of the operating units in the respective sectors. In addition, the net profit figure includes accounting treatment of reserves for doubtful debts, among other discretionary items. The adoption of a different policy on the treatment of the discretionary items might have a significant impact on the net profit figure.

#### ***E.5 Second board of stock exchange***

116. Since the market bloom of technology companies in the NASDAQ in the mid 1990's, the stock exchanges in many countries were interested in developing NASDAQ-style stock exchanges. The objective of setting up these exchanges is to allow growth-oriented companies, particularly technology companies, to raise fund and develop their operations.
  
117. There are two main features of the companies that attempt to be listed in the "second boards" of stock exchanges. First, these companies tend to be young companies with a limited operating record. Second, most of the companies are still in their development phase and do not have operating profits.
  
118. Table 11 summaries the number of listed companies, market capitalization, and turnover in the second boards of three European markets and seven Asian markets. In terms of number of listed companies and market capitalization, the London AIM stock market is the most significant. In 2002, there were two second boards in Paris, the Second Marché and the Nouveau Marché. There were 372 companies listed (5 of them were foreign companies) on the Second Marché with a market capitalization of US\$ 45.2 billion. The Nouveau Marché included 111 companies (7 of them foreign) with a market capitalization of US\$ 4.9 billion. The Neuer Markt of the Deutsche Börse had 201 listed companies (33 of them foreign) in 1999 with a market capitalization of US\$ 46.6 billion.

119. Among the Asian countries, Malaysia and Singapore had been the first-movers in developing their second boards. In 2002, 292 companies were listed in the Kuala Lumpur Second Board with a market capitalization of US\$ 4.2 billion. The SESDAQ in Singapore had 117 listed companies representing US\$ 1.7 billion of market capitalization.
120. The emergence of second boards in Asian countries present a number of corporate governance issues. First, companies listed on the second boards are mainly technology and Internet companies with an intrinsically high level of operating risk. It is conceivable that a fair number of these firms will not survive. In fact, the respective exchanges usually put forth a “buyers beware warning” with respect to second board companies. Hence, it is plausible that the high-risk nature of the second boards will induce investors to be even more cautious in making their investments. Second, these companies are typical young firms with a lack of operating history. Some companies might have a management team that was recently assembled. While a major concern on Asian markets is the usefulness of accounting figures, it is even more difficult to base on the accounting figures of second board companies and make projections of how the companies would perform in the future. Third, many of the Asian countries were enthusiastic to launch their second boards, but the mechanism of delisting these firms is lacking. Without an effective delisting mechanism, the second board markets may be represented over time by an increasing number of “bad” firms, and investors may further shy away from these markets.
121. Second boards also present a positive message to enhancing corporate governance. In general, second boards require that all firms report their financial figures on a quarterly basis. Compared to the more popular semi-annual reporting in most main boards, the second board companies are required to provide more timely disclosure of the financial performance of their companies.

### ***E.6 Legal system and enforcement***

122. The Asian stock exchanges had typically experienced a developmental stage in which the securities laws were derived from the company law and other laws and ordinances. In many cases laws were passed on a gradual basis and a framework of laws governing stock dealing and corporate governance might not be available.
123. More importantly, it is not clear in individual member countries on the enforcement and jurisdiction of certain activities that lead to negative impact on minority shareholders. Such activities include illegal practices such as undisclosed related-party transactions, self-dealing (of shares), insider trading, and bribery.
124. The legal system in Asian countries may also present obstacles for enforcing proper corporate governance principles. For example, it could be technically difficult and costly for minority shareholders to bring lawsuits against the corporate insiders who had allegedly violated their fiduciary duties. Such lawsuits are extremely rare in Asian countries. Similarly, class actions from a group of minority shareholders are also technically difficult to be implemented.
125. An exception can be found in Korea in which an institutional investor, Newrich Capital successfully brought a lawsuit against the former management of the Korea First Bank in 1999. This was conceivably the first of similar lawsuits that was won against the corporate insiders in Korea. Should more efficient enforcement is present, the threat of potential legal actions would possibly promote effective corporate governance.
126. However, there is always a debate on how far the enforcement should go to promote good governance practices while preserving the flexibility of corporate managers to pursue value-maximizing operations. An example can be illustrated by the enforcement in Hong Kong. Traditionally, insider-dealing cases were handled by a semi-official Insider Dealing Tribunal with limited jurisdiction and

involve a lengthy process. In 1999 the Hong Kong SAR government proposed a new consolidated securities bill that among other things, called for the enhancement of the enforcement power of the Securities and Futures Commission (SFC) and higher levels of responsibilities of corporate directors. One item concerns the possible criminal responsibilities of the directors of brokerage companies. The proposed draft law stated that directors were liable under criminal law. The proposal induced significant reaction from the investment community. One possible scenario is that international investment companies might have directors overseas and appointed an arms-length operation in Hong Kong. The legal liability under the proposal would be so significant that might deter international investment companies to set up their operating arms in Hong Kong. As a response to the reactions, the law was subsequently revised, including leaving the burden of proof to the SFC.

127. One point worth noting is that unlike the OECD markets in which much of the “basic protection” on investors is offered by their legal system and enforcement mechanism, the Asian markets are characterized by a still developing set of institutions and laws that offer similar protection. The design of the legal framework should include the balance between sufficient enforcement and preserving flexibility.

## **F. An illustration of East-West divergence in corporate governance - Japan**

### ***F.1 General overview***

128. Japan is the second largest economy after the United States. As discussed in previous materials, the Japanese capital markets also play significant roles in global capital markets. However, corporate governance in Japanese corporations continues to exhibit strong cultural factors indigenous to Japan. Since the slow down of the Japanese economy since the early 1990's, significant efforts have been placed to speed up the reform of corporate governance structure to be more in line with western countries. It should be noted, however, that the Japanese economy is a complex economy and the corporate culture a fairly unique culture

and that a rapid change is usually not a practical solution to the existing issues faced with by Japanese corporations.

### ***F.2 Board composition and ownership structure***

129. In Japan, the board of directors is composed of two elements: the board of directors that carries out the strategic decision-making; and the board of auditors, which audits management's execution of business activities.
130. The ownership of Japanese companies is often represented as a *keiretsu* or group of companies. Similar to the Rhineland model, a *keiretsu* acts like a closed economic system and member companies within a *keiretsu* provide complementary cooperative efforts towards other group companies.
131. There is significant cultural difference in Japanese corporations as compared with western corporations. For example, the traditional expectation on the key executives in a Japanese corporation is not what the “value maximizing” behavior that companies in an Anglo-Saxon model would expect. In Japan the *shacho* (president), equivalent to the CEO in the western corporate setting, is expected to be hard working, spirited, reliable, level-headed, has good communication skills, and a good grasp on where the company is heading. Such qualities, however, might not be sufficient to maximizing corporate value.

### ***F.3 Management style and the cultural aspects of corporate governance***

132. In general, the board of directors serves only as the leadership position of the company rather than involved in the devise of corporate strategies. The strategic decision-making is made by the executive directors who are managers of the company.
133. The board of auditors is responsible for *ex post facto* auditing of managerial result. Members of the board of auditors tend to distant themselves from the decision making process.

134. Because of the significant difference in the governance structure in Japan as compared with the ones in the western corporate world, substantial changes need to be made to the existing governance system. On the other hand, the Japanese government and regulatory bodies have recognized the increasing significance of the globalization of capital markets. Corporate governance is seen as an integral part of the capital market reform.

#### ***F.4 Recent developments***

135. As of 1997, the Japanese Corporate Governance Committee (CGC), which comprises of members from the academia, corporations, and the investment community, published an interim report of the progress in enhancing corporate governance in Japan as well as moving towards the convergence into the western standards of codes of practice.
136. The Japanese CGC provides a two-stage plan that covers a 5-year period to achieve the goals provided by the CGC. The first stage involves the strengthening of corporate governance practice within the framework of law and regulation. The longer-term development involves the more gradual convergence of Japanese the standard into international standards.
137. In 1997 *keidanren*, or the Japanese Federation of Economic Organizations, published a set of recommendations that addresses the shorter-term targets of improving governance practices in Japan. The recommendations include: (1) strengthening the role and responsibilities of inside and outside auditors; (2) reviewing of derivative lawsuit system, including the legal liability of corporate directors; and (3) initiatives by corporations to adopt and comply with practice guidelines.

## Summary of Individual Asian Countries

### A. Hong Kong

#### A.1 General overview

138. The primary set of rules and guidelines governing the behavior of listed corporations are the Rules Governing the Listing of Securities (Listing Rules) prepared by the Stock Exchange of Hong Kong (SEHK). The SEHK also prepares The Code of Best Practice and The Guidelines for Directors of Listed Companies, which are intended to furnish a “brief and practical introduction” to directors of listed companies concerning their responsibilities under the Listing Rules.

139. Since the Rules and Guidelines are intended to provide a brief introduction to the basic principles of corporate governance, it does not include detailed suggestions to issues such as the frequency of shareholder meetings, board size, etc.

#### A.2 Disclosure and transparency

140. Listed companies should provide accurate disclosure in the annual and interim reports. These statements should also clearly indicate that the reports are compiled with the *Code of Best Practice*.

141. In the event of a general meeting, all information on each item on the agenda of the Stockholders Meeting should be available 15 days prior to the date of the meeting.

142. Directors must be clear that they are individually and collectively responsible for the company’s compliance with the Listing Rules.

143. It is recommended that there be a mechanism that lends support to the Board in verifying compliance of the audit function, assuring that internal and external audits are performed with the highest objectivity possible and that the financial information is useful, trustworthy and accurate.

144. Fair disclosure requires disclosure of information in such a way that it does not place any person in a privileged dealing position or result in share prices, which do not reflect the latest available information.
145. All listed companies must include in their annual and interim reports a statement of compliance with the Code of Best Practice. The statement to be included in the annual report should clearly indicate whether the company has complied with the Code of Best Practice during the accounting period covered and, if the company has not complied with any part of the Code of Best Practice, reasons must be given to explain the failure to comply.

#### ***A.3 The equitable treatment of shareholder***

146. There is no specific discussion on the equitable treatment of shareholders, such as the voting rights of shareholders.
147. However, the Listing Rules requires that listed companies should provide a format containing detailed information and possible voting alternatives for voting in shareholder meetings.

#### ***A.4 Board composition***

148. The board should include independent non-executive directors. There is no specific definition on independent non-executive directors. However, the principle is that Independent Directors are persons selected for their abilities, experience and professional recognition.
149. Every non-executive director must ensure that he can give sufficient time and attention to the affairs of the issuer and should not accept the appointment if he cannot.
150. There is no specific guideline on the appointment of non-executive directors. However, if an independent non-executive director resigns or is removed from office, the Exchange should be notified of the reasons.

### ***A.5 The responsibilities of the board***

151. Every director, in the performance of his duties as a director, must (1) act honestly and in good faith in the interests of the company as a whole act for proper purpose; (2) be answerable to the company for the application or misapplication of its assets (3) avoid actual and potential conflicts of interest and duty; (4) disclose fully and fairly his interests in contracts with the company; (5) apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the company.

### ***A.6 Director compensation***

152. The directors' fees and any other reimbursement or emolument payable to an independent non-executive director shall be disclosed in full in the annual report and accounts of the issuer.

## **B. Korea**

### ***B.1 General overview***

153. The current version of corporate governance codes and guidelines is prepared and released by the South Korean Committee ("the Committee") on Corporate Governance, a non-governmental body convened in March 1999.
154. The Committee issued in September 1999 the "Code of Best Practice for Corporate Governance". The Code is intended to set as a model for Korean companies to structure and organize their internal control systems. The Code also serves as a standard for the review of relevant Korean laws.
155. The Codes addresses five areas: (1) shareholders; (2) board of directors; (3) audit systems; (4) stakeholders; and (5) market monitoring.

### ***B.2 Disclosure and transparency***

156. Shareholders should be provided with all necessary information in a timely manner, and the company should not show partiality to certain shareholders by providing undisclosed information.

157. Corporation should disclose all information, not limited to what is required by law that may materially affect the decision-making of shareholders and other stakeholders.
158. Corporations should prepare items for disclosure that may be easily understood, and should assist so that access to them is possible at minimal cost.
159. The boards of large public corporations, government-invested institutions and financial institutions shall establish an audit committee.
160. An audit committee shall be comprised of a minimum of three board members, a minimum two-thirds, including the committee chairman, shall be outside directors. At least one member should possess professional knowledge of auditing. A corporation without an audit committee should employ at least one standing auditor.
161. The audit committee (or the auditor) is responsible for: (1) auditing the appropriateness of the managers' execution of operations; (2) reviewing the soundness and reasonableness of the financial activities and the accuracy of the corporation's financial reports; (3) reviewing the adequacy of major accounting standards; (4) evaluating internal control systems; (5) approving the appointment / dismissal of persons heading internal auditing divisions; (6) evaluating the external auditors; (7) recommending external auditors; and (8) checking measures on those matters corrected as a result of auditing.
162. The audit committee should hold meetings at least once a quarter.
163. Meetings for outside directors should be held regularly. The company should appoint a representative among the outside directors to supervise such a meeting and to handle important issues delegated to them.

164. Corporations holding a significant portion of shares to enable foreigner to participate in corporate governance are advised to make disclosures in both English and Korean for audit reports and material timely disclosure.
165. Corporations should disclose detailed information on the share ownership status of controlling shareholders and on persons of special relation to them.

***B.3 The equitable treatment of shareholder***

166. The Code makes a discussion on the rights of the stakeholders of the company. The rights of stakeholders are defined and protected by the law and contracts. Stakeholders should have appropriate means to redress for potential infringement of rights.
167. Creditor rights. Corporations should observe creditor protection procedures in corporate activities such as mergers, capital decrease, and split mergers.
168. Labor relations. Corporations should faithfully observe labor-related issues.
169. Social responsibilities. Corporations should observe social responsibilities such as consumer protection and environmental protection.
170. Shareholders are a component of the stakeholders of the company. Shareholder rights are to be protected.
171. Shareholders hold fair voting rights according to the type and number of shares possessed, and all shareholders shall be equally treated concerning the access to corporate information.
172. Shareholders hold the right to one vote per share. However, there are certain classes of investors whose voting rights are restricted by law. It is recommended

- that cumulative votes be used in major corporate decisions, including the selection of new directors.
173. Corporations should provide a mechanism for minority shareholders to make nominations for a new director. Such initiatives should be announced at the general shareholder meeting.
  174. Institutional investors shall actively exercise their shareholder rights and monitor corporate management.
  175. Shareholders should have access to all necessary information prior to exercising their voting rights, and should be able to exercise their rights in simple and proper procedures.

#### ***B.4 Board composition***

176. There is no specific discussion on the size of the board. The general guideline is that the board should allow the discussions made to be fruitful and the decision made to be appropriate, swift, and prudent.
177. For large corporations, it is advised that the number of directors is appropriate for effectively managing internal committees.
178. The board shall include outside directors capable of performing their duties independently from management, controlling shareholders and the corporation. The number of outside directors should be such that the board is able to maintain practical independence.
179. It is recommended that financial institutions and large corporations should have a highly proportion of outside directors. Listed companies should have at least one-quarter of outside directors. Financial institutions and public sector companies should have at least one-half.

180. There is no explicit definition of being independent. The general rule is that an independent director is such that he/she does not hold interests to impose a conflict of interest with his/her role as an independent director.
181. It is required that if there is any change in the role of the independent director, the information should submit a corrected letter, which the company should disclose.

***B.5 The responsibilities of the board***

182. The board is responsible for making key management policy decisions in the best interest of the corporation and its shareholders. Directors should perform their duties in the best interest of the company and its shareholders.
183. The Code suggests that the board should focus on making key management decisions and delegate other less significant tasks to the other functions of the company.
184. Board members should have personal integrity, capacity to read and understand financial statements, absence of conflict of interest, time availability, and motivation.
185. The board should include non-executive directors. Non-executive directors should be persons of caliber, credibility, and have the necessary skill and experience to bring independent judgment to the strategy, performance, and resources of the company.
186. There should be formal and transparent procedures in the selection and appointment of new directors.
187. Each new board member should go through an orientation and education program with respect to policies, financial status, facilities, and personnel of the company.

188. Board members should be re-elected at regular time intervals. Such a practice provides the board with more effective control and also provides shareholders means to evaluate the performance of board members and replace them if necessary.

### ***B.6 Director compensation***

189. Board members should be hired by a nomination committee that is organized with fairness and independence. At least half of the nomination committee should be outside directors.
190. The activities of board members should be subject to fair evaluation and the compensation should commensurate with the evaluation results. The evaluation results should be disclosed.
191. Remuneration should be decided by the board within the limits approved by the general shareholder meeting.

## **C. Malaysia**

### ***C.1 General overview***

192. The current regulatory environment in Malaysia came to being through a High Level Finance Committee established by the Malaysian government in March 1998. The Committee published its Report on Corporate Governance in March 1999.
193. The Report proposes that the Corporate Governance Code be backed by the listing rules of the Kuala Lumpur Stock Exchange (“KLSE”). Companies listed on the KLSE would be required to disclose the extent of their compliance with the best practices set out in The Code.
194. The Code consists of Principles of Corporate Governance, Best Practices in Corporate Governance, Principles & Best Practices for Other Corporate

Participants and Explanatory Notes and certain other practices that are proposed merely for consideration.

195. The Code states that the single overriding objective by all listed companies, whatever the size or type of business, is the preservation and enhancement over time of their shareholders' investment. The main objective of corporate governance is therefore in the monitoring of the behavior of the board.
196. The Code proposes that every listed company should be headed by an effective board to lead and control the company. It also expressively endorses the unitary board structure for Malaysian companies. It stresses the dual role of the board – leadership and control – and the need to be effective in both.

### ***C.2 Disclosure and transparency***

197. The Code states that the board should present a balanced and understandable assessment of the company's position and prospects.
198. Each listed company should include an audit committee and that the board should disclose, in an informative way, details of the activities of the audit committee, the number of audit meetings held each year, and details of attendance of each individual director in respect of meetings.
199. The audit committee should comprise at least three non-executive directors, a majority of whom is independent, with written terms of reference that deal clearly with its authority and duties. The Chairman of the audit committee should be an independent non-executive director.
200. The duties of the audit committee should include: (i) to appoint of the external auditor; (ii) to discuss with the external auditor the nature and scope of the audit, and ensure co-ordination in the audit process; (iii) to review the half-year and annual financial statements of the board; (iv) to discuss problems and reservations arising from the interim and final audits, (v) to review the external

- auditor's management letter and management's response; (vi) where an internal audit function exists, to ensure that it is adequately resourced and has appropriate standing within a company, and to review the internal audit program; (vii) to consider any related party transactions that may arise within the company or group; (viii) to consider the major findings of internal investigations and management's response; and (ix) to consider other topics as defined by the board.
201. The board should establish formal and transparent arrangements for maintaining an appropriate relationship with the company's auditors.
202. The external auditors should independently report to shareholders in accordance with statutory and professional requirements and independently assure the board on the discharge of its responsibilities in accordance with professional guidance.
203. The audit should cover not only financial controls but operational and compliance controls, and risk management, since there are potential threats to shareholders' investment in each of these areas.

### ***C.3 The equitable treatment of shareholder***

204. There is no explicit discussion on voting practice and voting rights of shareholders. However, it states that institutional shareholders have a responsibility to make considered use of their votes.
205. The Best Practice defines a "significant shareholder" as a shareholder with the ability to exercise a majority of votes for the election of directors.

### ***C.4 Board composition***

206. There is no explicit discussion on board size. The Best Practice states that each company should examine the size of its board with a view to determining the impact of the number upon its effectiveness.

207. It is recommended that due to the importance and particular nature of the Chairman's role, the position of the Chairman should in principle be separate from that of the Chief Executive.
208. The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision-making.
209. The Best Practice states that independent non-executive directors need to make up at least one-third of the membership of the board.
210. The term "independent" is defined as directors who are not officers of the company; who are neither related to its officers nor represent concentrated or family holdings of its shares; who, in the view of the company's board of directors, represent the interests of public shareholders, and are free of any relationship that would interfere with the exercise of independent judgment.
211. In circumstances where a company has a significant shareholder, the board should also include a number of directors, which fairly reflects the investment in the company by shareholders other than the significant shareholder. For this purpose, a "significant shareholder" is defined as a shareholder with the ability to exercise a majority of votes for the election of directors.
212. In circumstances where the shareholder holds less than the majority but is still the largest shareholder, the board will have to exercise judgment in determining what is the appropriate number of directors which fairly reflects the investment in the company by the remaining holders of the shares.
213. The board should appoint a committee of directors comprised exclusively of non-executive directors, a majority of whom is independent, with the responsibility for proposing new nominees for the board and for assessing directors on an ongoing

basis. The actual decision as to who shall be nominated should be the responsibility of the full board after considering the recommendations of such a committee.

214. Committees. The board should spell out the authority of each of the committees formed and in particular, whether each committee has the authority to act on behalf of the board or simply has the authority to examine a particular issue and report back to the board with a recommendation.

### ***C.5 The responsibilities of the board***

215. The board's task is to approve appropriate policies and to approve the performance of management in implementing them.
216. While Directors as a board are responsible for relations with stakeholders, they are accountable to the shareholders. The policy considerations underlying such a definition of board responsibility are fundamental to capital formation and the financing of businesses.
217. The board should explicitly assume the following responsibilities, which facilitate the discharge of the board's stewardship responsibilities: (1) reviewing and adopting a strategic plan for the company; (2) overseeing the conduct of the company's business to evaluate whether the business is being properly managed; (3) identifying principal risks and ensuring the implementation of appropriate systems to manage these risks; (4) succession planning, including appointing, training, fixing the compensation of and, where appropriate, replacing senior management; (5) developing and implementing an investor relations program or shareholder communications policy for the company; and (6) reviewing the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.

218. The board should meet regularly, with due notice of issues to be discussed, and should record its conclusions in discharging its duties and responsibilities.
219. Companies should use the Annual General Meeting (AGM) to communicate with private investors and encourage their participation. The AGM should also act as the main way of achieving greater participation of private investors in corporate governance.
220. The Chief Executive Officer. The board, together with the Chief Executive Officer, should develop position descriptions for the board and for the Chief Executive Officer, involving definition of the limits to management's responsibilities. In addition, the board should approve, or develop with the Chief Executive Officer, the corporate objectives, which the Chief Executive Officer is responsible for meeting.
221. Non-executive directors. Non-executive directors should be persons of caliber, credibility and have the necessary skill and experience to bring an independent judgment to bear on the issues of strategy, performance and resources including key appointments and standards of conduct.
222. Directors. There should be a formal and transparent procedure for the appointment of new directors to the board. Each company should provide an orientation and education program for newly recruited directors.

#### ***C.6 Director compensation***

223. Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.
224. The board should appoint remuneration committees, consisting wholly or mainly of non-executive directors, to recommend to the board the remuneration of the

- executive directors in all its forms, drawing from outside advice as necessary.  
Executive directors should play no part in decisions on their own remuneration.  
Membership of the remuneration committee should appear in the directors' report.
225. The company should disclose in its annual report details of the remuneration of each director.
226. Re-election of directors at regular intervals is recommended to promote effective boards and also provide shareholders the opportunity to review the directors' performance in turn and where necessary to replace them.

## D. Thailand

### *D.1 General overview*

227. Corporate governance practices are mainly established and benchmarked upon the "Roles, Duties and Responsibilities of the Directors of Listed Companies" published by the Stock Exchange of Thailand ("SET"). The manual contains both a Code of Best Practice and sections on additional guidelines.
228. The Code and other guidelines in the manual are not intended to be legally binding. They are intended to provide a guiding standard for boards of companies listed on the SET and improve understanding of the functions of directors.
229. The board has the role to ensure management's accountability to shareholders by preserving their rights and interests, and by clearly and fully disclosing information to shareholders.
230. Board members should conduct their duties honestly, comply with all laws, the objectives and the articles of association of the company, and the resolutions of any shareholder meetings in good faith, and with care to preserve the interests of the company.

## ***D.2 Disclosure and transparency***

231. Listed companies are required to disclose all necessary information to allow the general public to make informed investment decisions. Such disclosures also enable the SET to indirectly supervise the business activities of listed companies.
232. The disclosed information must be correct, sufficiently detailed and promptly released to ensure active, fair and orderly trading on the SET.
233. All investors must be provided with equal access to such information.
234. Each board of directors should establish an Audit Committee. The role of the audit committee is to ensure the effective and efficient control and review of a company's administration, internal audit procedures, the preparation of financial statements and the general disclosure of material information to investors and shareholders.
235. An audit committee should comprise solely the independent directors of the company.
236. The audit committee should be the informed, vigilant and effective overseers of the company's financial reporting process and internal controls. In general, the audit committee should be responsible for reviewing a wide range of financial matters including the annual and half-year profit figures, financial statements and accompanying reports. It should also monitor the controls, which are in force to ensure the integrity of the financial information reported to the company's shareholders.
237. The audit committee should have explicit authority to investigate any matters within its duties, the resources which it needs to do so, and full access to information. The audit committee should also be able to obtain outside professional advice, if necessary, at the company's expense.

238. Independent directors should provide other opinions to the shareholders of the company if they disagree with the opinions of the independent financial advisors.
239. If any external auditor resigns or is dismissed, the board must fully explain the reasons to the SET.

***D.3 The equitable treatment of shareholder***

240. A board of directors holds the power to manage the business of the company. Shareholder approval is, however, required for certain crucial decisions. These decisions are set out in the Public Limited Companies Act of 1992 (the 1992 Act) and the Articles of Association.
241. Such activities include amendments to the company's Memorandum of Association or Articles of Association, authorizing an increase or decrease in capital, appointment or removal of directors, sale of major assets or transfer of business, the purchasing or acquiring of another listed company's or private company's business, entering, amending or ceasing a major leasing agreement, authorizing other people to manage the company's business, the payment of dividends, the issuance of debentures, a merger with another company, an amalgamation with another company and a company's dissolution.
242. Independent directors are expected to, in general, guard against any acts by the board of directors, which may prejudice the interests of the company's minority shareholders.
243. The 1992 Act prescribes that directors shall be elected at a shareholders' meeting in accordance with the rules and procedures as prescribed in the Articles of Association. If the Articles of Association do not provide the rules and procedures for the appointment of directors, the Act states that cumulative voting should be applied.

244. In the case of a vacancy on the board of directors for reasons other than the expiration of a director's term in office, the board of directors shall elect another person as a substitute director. The substitute director shall hold office only for the remaining term of office of the director whom he or she replaced. However, in appointing a director, the board of directors should clearly specify the powers of the director in operating the businesses of the company.

#### ***D.4 Board composition***

245. The number of directors comprising the board of directors of a company is set out in the Articles of Association as being no less than five directors.

246. At least two directors must be independent directors. Additional independent director(s) must be appointed within three months if there are ever less than two independent directors.

247. The 1992 Act does not provide for independent directors and their qualifications. It is the SET's regulations that require the board of directors of a listed company to comprise at least two independent directors.

248. The Code states that independent directors must be independent of any major shareholder and not involved in the day-to-day operations of the listed company. An independent director must meet all of the following requirements: (i) be independent from the major shareholders of the company or any shareholder in their group. (ii) not be an employee, staff member or an adviser receiving a regular salary or other regular benefit from the company or its affiliated company, associated company or related company; (iii) have no shares in their own name, or in a related person's name, representing more than 0.5% of the respective paid up capital of the company, an affiliated company, associated company or related company; (iv) be able to protect the interests of all shareholders of the company equally; (v) be able to prevent conflicts of interest between the company and its management or major shareholders or other companies which have the same

- management group, or major shareholders, as the company; and (vi) be able to attend board meetings to make decisions on significant company activities.
249. Independent directors should demonstrate independent judgment to prevent any conflicts of interest. If they oppose any proposal they should state their reasons for disagreeing in the minutes of the board meeting.
250. Potential directors should only accept the position of director or non-executive director on the board of listed companies that he/she has the time to attend appropriately.
251. Each member of a board of directors must possess a good education, a high standard of business knowledge and experience, and a company belief in ethical corporate behavior. A director must also perform their duties with care and loyalty and avoid any conflict of interest between the company and its management or the major shareholders.
252. It is not required that all directors need not have domicile in Thailand. However, not less than half of them should reside within Thailand.

***D.5 The responsibilities of the board***

253. The board is responsible for implementing and directing the company's policies, as well as monitoring and supervising its operations to maximize economic value and shareholders' wealth.
254. The board should ensure that the company has management with the competency, knowledge and experience to run the business, and that the company is determined to carry on the business continuously. It should continuously follow and monitor the business performance and operations of the company.
255. Directors should conduct themselves honestly and with integrity. They should clearly understand the mission, objectives, capability and efficiency of the listed

company and be prepared to devote their time and resources to attending and performing their duties at every board meeting.

256. The board should appoint a company secretary to take care of all the directors' activities and to conduct the company's business in full compliance with all laws and regulations. It should also ensure that the company secretary completes the minutes for each board of directors and shareholder meeting within the period specified in the relevant laws.
257. Directors should examine all documents relating to all matters that concern the board of directors. If something is suspected, management must be asked to explain as quickly and clearly as possible.

#### ***D.6 Director compensation***

258. Each listed company should have a Nominating Committee and a Remuneration Committee.
259. The remuneration committee should comprise solely the independent directors of a company.
260. The remuneration committee is responsible for determining the remuneration and other benefits for ordinary directors, members of the executive committee and top executives of the company.
261. The remuneration of directors as approved by a shareholder meeting should be fully disclosed in the company's annual report.

## **Conclusion and Recommendations**

### **A. Conclusion**

262. This report is the first step in analyzing the state of development of corporate governance in several Asia-Pacific countries with respect to the international standards set forth for the OCED countries. The report provides fairly comprehensive coverage of the major aspects of corporate governance in Hong Kong, Korea, Thailand, and Malaysia. These economies, however, do not represent the entirety of the markets that have adopted codes of best practice for corporate governance. Further studies can be extended to other economies (such as Singapore and Indonesia) to provide a more exhaustive comparison of corporate governance codes in the Asia-Pacific region.
263. Our study reviews that since the late 1990's many Asian countries had put efforts to start to draft their corporate governance codes of practice and attempted to enhance their level of corporate governance standard.
264. The ultimate goal of corporate governance is to monitor the behavior of the board in making management decisions that are in alignment with general shareholder interest. Since the corporate finance environments do differ across the various Asian countries with respect to legal, regulatory, economical, social, and cultural factors, it is obvious that a single standard would not apply to all Asian countries.
265. There are two issues concerning the development of corporate governance practices: enhancement of standards within each country and convergence of standards across different countries. Our view is that the two issues should be dealt with simultaneously. On the operational side, however, we are in favor of the view that each individual country should work to step up their respective standard before a unified Code of Practice can be applied.
266. We note that there is a fundamental difference in the corporate setting between OECD countries and Asian countries regarding corporate governance issues. The

- OECD Codes are derived from a model of devised ownership of large corporations in which there is a clear separation of ownership (of majority of the equity) and control. In many Asian countries, family control is a common phenomenon and that the majority shareholders can take a key management role in the company.
267. Based on this difference, we distinguish that in the OECD model the key agency issue is monitoring the management who has insignificant ownership of the equity. In the Asian model the key issues are to bridge the information gap between corporate insiders and investors, and to mitigate the potential conflict of interest between the majority shareholders and other minority shareholders.
268. Another major distinction between OECD countries and Asian countries is in the degree of participation by institutional investors. In OECD markets, institutional investors hold a substantial portion of publicly trading equities and have strong demand in timely and accurate information and assurance of good corporate governance practice. In Asian countries, however, institutional investors typically represent a smaller portion of stock market activities. Corporate managers hence may not see an immediate need to impose corporate governance policies.
269. Studies have suggested that there is a demand for good governance practice and good governance could be rewarded by a premium paid investors. On a macro-economic consideration, good corporate governance will contribute to the stability of the local equity market since investors, in particular foreign institutional investors, will have a higher interest to commit long-term funds to the local market. Such a commitment will be beneficial to the long-term economic development in Asian countries.
270. We have made a “cross-sectional” comparison of key issues in the Codes of Practices in several Asian countries. These sets of Codes differ significantly in their scope and level of detail. Our view is that individual countries would benefit

by reviewing the key issues faced with in their respective country and review which format of the Codes and Guideline would best fit their internal corporate setting.

## B. Recommendations

### ***B.1 Short-term recommendations***

271. Disclosure of information. We propose that one of the more immediate needs is to allow investors access to timely and accurate information on the financial and non-financial aspects of the corporations. We propose the following areas to implement measures to reinforce fair and accurate information disclosure:
- Reporting standard and format. Accounting boards and the audit profession shall review the standard and format in which financial information is disclosed. Efforts should be on a country-by-country basis and also on a regional basis since the reporting format can deviate fairly substantially across different countries.
  - Regulation by stock exchanges and regulating bodies. The stock exchange is usually the primary regulatory institution concerning the quantity and quality of information disclosed by listed companies. The stock exchange and the other regulatory bodies can work to review and impose whether the information disclosure is sufficient and make changes when necessary.
  - Presentation format. In several countries the presentation format of information disclosed is in technical or professional terms that are difficult for the average investor to understand. Stock exchanges and regulatory bodies should work to simplify the language of such information releases so that investors can have a reasonable understanding of the content of the information.
  - Role of the external auditor. We suggest that external auditors should take a more active role to reinforce the auditing profession and state areas in which investors should take note.
272. Regulation and enforcement. The current status is that many Asian countries have adopted a form of governance guidelines and code of best practice. However, it remains to be seen if listed corporations are following these guidelines and codes. An effective means to facilitate the adoption of these practices is to have the

regulatory body require that corporations' compliance to these practices. Also, the regulatory body should have the power to enforce the practices in listed companies. Regulators should take a consistent standard to apply to all listed companies so that corporate managers can identify with the new guidelines.

### ***B.2 Medium-term recommendations***

273. Education. A significant element in promoting good governance practices is that corporate board members need to voluntarily participate in the process. Therefore, local governments and regulators need to establish education programs so that good governance becomes a common practice in the investment community.

274. Studies on corporate governance issues. There is a common pattern of an inadequacy of case studies on the abuse of the existing governance rules. Because of this insufficiency, regulators cannot use real life examples and devise adequate rules and regulations to prevent such poor practices from happening. It is also because of this inadequacy that regulators might have the intention to "import" the OECD rules and try to apply them to their local markets. We suggest that regulators and academic institutions (e.g., law faculties and business schools) initiate to build local case libraries of corporate governance case studies. The information from this documentation will enhance the promotion of good corporate practices in the legislative process and also in other education programs.

### ***B.3 Long-term recommendations***

275. High-level discussion on standard setting. The long-term sustainability of promoting good governance practices requires that high-level support from the government, regulatory bodies and stock exchanges are present. We suggest that high-level forums and conferences on corporate governance be organized on a regular (say annual) basis. These activities will form a solid component in building the awareness and a positive culture for corporate governance.

## Appendices

**Table 1. Institutional ownership structures in selected OECD countries, 1990-91**

	United States	United Kingdom	Germany	Japan
<i>A. Institutional investors</i>				
Banks	0.30	0.90	8.90	25.20
Insurance companies	5.20	18.40	10.60	17.30
Pension funds	24.80	30.40	0.00	0.90
Investment companies	9.50	11.10	0.00	3.60
<b>Subtotal</b>	<b>39.80</b>	<b>60.80</b>	<b>19.50</b>	<b>47.00</b>
<i>B. Other investors</i>				
Non-financial businesses	0.00	3.60	39.20	25.10
Household	53.50	21.30	16.80	23.10
Government	0.00	2.00	6.80	0.60
Foreign	6.70	12.30	17.70	4.20
<b>Subtotal</b>	<b>60.20</b>	<b>39.20</b>	<b>80.50</b>	<b>53.00</b>
<b>TOTAL</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: Kester (1997), p. 234.

**Table 2. Summary of OECD Principles of Corporate Governance**

Rights of shareholders	<ol style="list-style-type: none"> <li>1. Recognition of basic shareholder rights</li> <li>2. Shareholders have right to participate in decisions concerning fundamental corporate changes</li> <li>3. Voting rights of shareholders</li> <li>4. Disclosure of disproportionate voting rights of certain shareholders to obtain a degree of control</li> <li>5. Markets for corporate control should be allowed to function</li> <li>6. Shareholders should consider the costs and benefits of exercising their voting rights</li> </ol>
Equitable treatment of shareholders	<ol style="list-style-type: none"> <li>1. All shareholders of the same class should be treated equally</li> <li>2. Insider trading and abusive self-dealing should be prohibited</li> <li>3. Board members and managers should disclose material interests</li> </ol>
Role of stakeholders	<ol style="list-style-type: none"> <li>1. Assure that rights of stakeholders are protected by law</li> <li>2. Stakeholders should have the opportunity to obtain effectiveness redress for violation of their rights</li> <li>3. Permit performance-enhancing mechanisms for stakeholder participation</li> <li>4. Stakeholders should have access to relevant information in the corporate governance process</li> </ol>
Disclosure and transparency	<ol style="list-style-type: none"> <li>1. Scope of material information to be disclosed</li> <li>2. Information should be prepared in accordance with high accounting standards</li> <li>3. Annual audit be conducted by an independent auditor</li> <li>4. Fair, timely and cost-effective means of disseminating information</li> </ol>
Responsibilities of the board	<ol style="list-style-type: none"> <li>1. Board members should act on the best interest of the company with due diligence and care</li> <li>2. The board should treat all shareholders fairly</li> <li>3. The board should ensure compliance with the law and take account the interest of stakeholders</li> <li>4. Definition of key functions of the board</li> <li>5. The board should exercise objective judgment independent from management</li> <li>6. Board members should have access to accurate, relevant and timely information</li> </ol>

Source: OECD Principles of Corporate Governance (1999).

**Table 3. Investors' willingness to pay a premium for good corporate governance**

Panel A – Investors willing to pay a premium (%)

Region	2002 (%)	2000 (%)
Western Europe	78.0	81.0
Asia	78.0	89.0
North America	76.0	81.0
Latin America	76.0	83.0
Eastern Europe/Africa	73.0	N.A.
<b><i>Average</i></b>	<b>76.2</b>	<b>83.5</b>

Panel B – Average premiums of those investors willing to pay premium (%)

Country	2002 (%)	2000 (%)
<i>A. OCED Countries</i>		
France	13.0	20.0
Japan	21.0	20.0
Germany	13.0	20.0
United Kingdom	12.0	18.0
United States	14.0	18.0
<b><i>Average</i></b>	<b>14.6</b>	<b>19.2</b>
<i>B. Non-OCED Countries in Asia</i>		
Indonesia	25.0	27.0
Korea	20.0	24.0
Malaysia	22.0	25.0
Thailand	20.0	26.0
Taiwan	19.0	20.0
<b><i>Average</i></b>	<b>21.2</b>	<b>24.4</b>

Source: McKinsey 2002

**Table 4. Market Capitalization of domestic shares (US\$ million)**

Exchange	End 2002	End 2001	Change (%)
<i>A. Major OECD exchanges</i>			
NYSE	9,015,271	11,026,587	-18.24
Nasdaq	1,994,494	2,739,675	-27.20
Tokyo	2,069,299	2,264,528	-8.62
London	1,800,658	2,164,716	-16.82
Euronext*	1,538,654	1,889,455	-18.57
Frankfurt	686,014	1,071,749	-35.99
Toronto	570,223	611,493	-6.75
<b>Subtotal</b>	<b>17,674,613</b>	<b>21,768,203</b>	<b>-18.81</b>
<i>B. Other Asian exchanges</i>			
Australian	380,087	375,598	1.20
Hong Kong	463,055	506,073	-8.50
Jakarta	30,067	22,998	30.74
Korea	215,662	194,470	10.90
Kuala Lumpur	122,892	118,981	3.29
New Zealand	21,715	17,736	22.43
Philippine	18,183	20,606	-11.76
Singapore	101,554	117,338	-13.45
Taiwan	261,311	292,872	-10.78
Thailand	45,406	35,950	26.30
<b>Subtotal</b>	<b>1,659,932</b>	<b>1,702,622</b>	<b>-2.51</b>
<b>World Total **</b>	<b>22,809,564</b>	<b>26,904,918</b>	<b>-15.22</b>

Source: International Federation of Stock Exchanges (FIBV)

\* Euronext included Amsterdam, Brussels, Lisbon and Paris

\*\* World total as sum of 49 exchanges reported in the FIBV database

**Table 5. Total equity capital raised (US\$ million)**

Exchange	2002			2001			Change (%)
	Listed Companies	Newly Listed Companies	Total	Listed Companies	Newly Listed Companies	Total	
NYSE	18,000	28,300	46,300	49,290	32,100	81,390	-43.11
Nasdaq	11,083	4,500	15,583	23,981	7,840	31,821	-51.03
Tokyo	16,031	N.A.	16,031	16,917	N.A.	16,917	-5.23
London	18,095	8,093	26,189	20,113	9,499	29,611	-11.56
Euronext*	30,794	3,209	34,003	45,297	34,956	80,253	-57.63
Frankfurt	-	203	203	-	2,573	2,573	-92.12
Toronto	8,646	5,808	14,454	5,967	7,624	13,591	6.35
<b>Subtotal</b>			<b>152,763</b>			<b>256,156</b>	<b>-40.36</b>
Australian	9,430	2,880	12,310	5,541	1,115	6,656	84.95
Colombo	10	1	11	2	0	2	360.61
Hong Kong	7,499	6,665	14,164	4,964	3,297	8,261	71.46
Jakarta	802	121	923	400	123	523	76.41
Korea	1,040	5,009	6,049	108	3,938	4,047	49.47
Kuala Lumpur	1,553	1,835	3,388	412	295	707	378.89
New Zealand	570	665	1,235	332	519	851	45.16
Philippine	709	77	786	139	5	143	448.79
Singapore	0	1,208	1,208	0	857	857	40.94
Taiwan	1,067	655	1,722	1,152	386	1,538	11.97
Thailand	1,606	217	1,823	2,430	777	3,207	-43.15
<b>Subtotal</b>			<b>42,412</b>			<b>26,792</b>	<b>58.30</b>
<b>World Total**</b>			<b>261,984</b>			<b>334,813</b>	<b>-21.75</b>

Source: International Federation of Stock Exchanges (FIBV)

\* Euronext included Amsterdam, Brussels, Lisbon and Paris

\*\* World total as sum of 49 exchanges reported in the FIBV database

**Table 6. Significance of stock markets in the economy in 2001 (US\$ million)**

	Stock market capitalization	GDP	%
United States*	13,827	10,082	137.14
United Kingdom	2,165	1,423	152.15
Japan	2,294	4,141	55.39
France	N.A.	1,310	N.A.
Germany	1,072	1,846	58.06
Canada	611	705	86.71
Australia	376	358	104.94
Hong Kong	506	162	312.76
Indonesia	27	153	17.49
Korea	194	422	46.07
Malaysia	119	88	135.13
New Zealand	18	50	35.14
Philippines	21	71	28.85
Singapore	117	86	137
Sri Lanka	1	16	8.5
Taiwan	293	N.A.	N.A.
Thailand	36	115	31.32

Source: IMF International Financial Statistics yearbook 2001

\* US market capitalization and capital raised includes Amex, Chicago, Nasdaq and NYSE

**Table 7. Turnover value (US\$ million)**

Exchange	2002		2001	
	Domestic Companies	Foreign Companies	Domestic Companies	Foreign Companies
NYSE	9,410,337	701,696	9,601,548	787,343
Tokyo	1,551,127	518	1,655,695	406
Nasdaq	7,000,343	251,537	10,464,898	469,185
London	1,881,103	2,104,628	1,843,956	2,656,076
Euronext*	1,955,603	18,107	2,056,033	14,099
Germany	1,110,392	101,909	1,288,481	134,890
Toronto	397,187	238	448,462	401
<b>Subtotal</b>	<b>23,306,092</b>	<b>3,178,633</b>	<b>27,359,073</b>	<b>4,062,400</b>
<b>All Companies</b>		<b>26,484,725</b>		<b>31,421,473</b>
Australian	290,946	4,453	241,323	3,139
Hong Kong	193,685	257	238,145	212
Jakarta	13,050	0	9,410	0
Korea	596,435	0	379,548	0
Kuala Lumpur	32,623	290	23,585	290
New Zealand	7,514	1,268	8,527	1,308
Philippine	3,045	48	3,050	79
Singapore	NA	NA	NA	NA
Taiwan	633,226	290	541,491	257
Thailand	41,280	0	30,804	0
<b>Subtotal</b>	<b>1,811,804</b>	<b>6,606</b>	<b>1,475,883</b>	<b>5,285</b>
<b>All Companies</b>		<b>1,818,410</b>		<b>1,481,168</b>
<b>TOTAL</b>		<b>28,303,135</b>		<b>32,902,641</b>

Source: International Federation of Stock Exchanges (FIBV)

\* Euronext included Amsterdam, Brussels, Lisbon and Paris

**Table 8. Average amount and value of stock trading**

	Average Amount Traded		Number of Transactions		Average Value of	
	per day (US\$ million)		per day ('000)		Transactions (US\$ '000)	
	2002	2001	2002	2001	2002	2001
NYSE	40,917.3	42,294.5	2164.94	1368.75	18.9	30.9
Nasdaq	28,788.1	44,091.0	2379.18	2435.97	12.1	18.1
Tokyo	6,358.7	6,747.6	NA	NA	NA	NA
London	15,878.3	17,866.3	151.80	129.09	104.6	138.4
Euronext*	7,797.5	N.A.	253.17	NA	30.8	36.6
Germany	4,791.7	5,626.0	290.41	372.58	16.5	15.1
<b>Subtotal</b>	<b>104,531.6</b>	<b>116,625.4</b>	<b>5,239.49</b>	<b>4,306.40</b>		
Australian	1,167.6	966.3	55.34	52.52	21.1	18.4
Hong Kong	785.4	991.8	83.55	99.18	9.4	10.0
Jakarta	53.3	38.3	12.69	14.73	4.2	2.6
Korea	2,445.2	1,543.2	788.77	643.00	3.1	2.4
Kuala Lumpur	132.8	97.9	51.08	54.39	2.6	1.8
New Zealand	35.4	39.6	2.12	2.73	16.7	14.5
Osaka	504.1	709.4	18.13	14.24	27.8	49.8
Philippine	12.6	12.7	2.03	2.59	6.2	4.9
Singapore	251.2	284.4	NA	NA	NA	NA
Taiwan	2,555.0	2,220.9	690.54	584.45	3.7	3.8
Thailand	168.5	125.8	52.4	39.1	2.3	2.4
<b>Subtotal</b>	<b>8,111.1</b>	<b>7,030.3</b>	<b>1756.66</b>	<b>1506.93</b>		

Source: International Federation of Stock Exchanges (FIBV)

\* Euronext included Amsterdam, Brussels, Lisbon and Paris

**Table 9. Regulatory bodies of major stock exchanges**

<b>Exchange</b>	<b>Supervisory Body</b>	<b>Clearing &amp; Settlement Organization</b>
New York	Securities & Exchange Commission (SEC)	DTCC - Depository Trust & Clearing
NASD	Securities & Exchange Commission (SEC)	National Securities Clearing Corporation (NSCC) & Depository Trust Company (DTC)
Tokyo	Financial Services Agency & Securities and Exchanges Surveillance Commission	TSE, Japan Securities Clearing Corp. (JSCC)
London	Financial Services Authority (FSA)	CREST
Paris	CMF / COB	CLEARNET SA
Deutsche Börse- Frankfurt	The market supervisory Office Wiesbaden / German Federal securities affairs supervisory body (BAFin), the local State stock market supervisory authority and the stock market internal trading supervision and monitoring body.	Clearstream International
Toronto	Ontario Securities Commission	Canadian Depository for Securities
Australian Stock Exchange	Co-regulatory regime – ASX and the Australian Securities and Investments Commission (ASIC)	ASX Settlement and Transfer Corporation
Hong Kong	Securities & Futures Commission (SFC)	Hong Kong Securities Clearing Co. Ltd
Jakarta	BAPEPAM (Capital Market Supervisory Agency)	Indonesia Clearing and Guarantee Corporation (PT KPEI)
Korea	Financial Supervisory Commission (FSC)	Korea Stock Exchange * The Korea Securities Depository (KSD) acts as KSE's agent for the settlement.
Kuala Lumpur	Securities Commission	Securities Clearing Automated Network Services Sdn. Bhd.
New Zealand	Self-regulated	FASTER
Philippine	Securities & Exchange Commission (SEC)	Securities Clearing Corp. of the Philippines (SCCP)
Singapore	Monetary Authority of Singapore	The Central Depository (Pte) Ltd Options Clearing Company (Pte) Ltd
Taiwan	Securities & Futures Commission	No Independent clearing & settlement organization

Source: International Federation of Stock Exchanges (FIBV)

**Table 10. Total value of listed corporate assets that families control**

Country	No. of Corporations Surveyed	Share of total market capitalization (%)	% Family-owned (20%+ control)	% State-owned	Total value of listed corporate assets that families control	
					Top 5 families	Top 10 families
Hong Kong	330	78%	66.7	1.4	26.2	32.1
Indonesia	178	89%	71.5	8.2	40.7	57.7
Malaysia	238	74%	67.2	13.4	17.3	24.8
Philippines	120	82%	44.6	2.1	42.8	52.5
Singapore	221	96%	55.4	23.5	19.5	26.6
South Korea	345	76%	48.4	1.6	29.7	26.8
Taiwan	141	66%	48.2	2.8	14.5	18.4
Thailand	167	64%	61.6	8.0	32.2	46.2

Source: Finance Asia, Vol. 5, Issue 4, February 2001, page 27

**Table 11. Second boards of stock exchanges**

Exchange	Name of the Market	2002			2001			% Change 2002/01
		Domestic Companies	Foreign Companies	Total	Domestic Companies	Foreign Companies	Total	
<b>A. Number of companies</b>								
Deutsche Börse	<i>Neuer Markt</i>	198	42	240	272	54	326	<b>-26.38</b>
London	<i>AIM</i>	654	50	704	587	42	629	<b>11.92</b>
Euronext	<i>New Market</i>	147	11	158	161	13	174	<b>-9.2</b>
Hong Kong	<i>Growth Enterprise Market (GEM)</i>	166	0	166	111	0	111	<b>49.55</b>
Kuala Lumpur	<i>Second Board</i>	292	0	292	292	0	292	<b>0</b>
Kuala Lumpur	<i>Mesdaq</i>	12	0	12	4	0	4	<b>200</b>
Osaka	<i>New Market Section</i>	4	0	4	4	0	4	<b>0</b>
Singapore	<i>Sesdaq</i>	116	1	117	106	1	107	<b>9.35</b>
Thailand	<i>Market for Alternative Investment (MAI)</i>	9	0	9	3	-	3	<b>200</b>
Tokyo	<i>Mothers</i>	43	0	43	36	0	36	<b>19.44</b>
<b>B. Market capitalization (US\$ million)</b>								
Deutsche Börse	<i>Neuer Markt</i>	10,342	N.A.	N.A.	44,460	N.A.	N.A.	<b>-76.74</b>
London	<i>AIM</i>	16,433	N.A.	N.A.	16,893	N.A.	N.A.	<b>-2.72</b>
Euronext	<i>New Market</i>	7,244	N.A.	N.A.	13,604	N.A.	N.A.	<b>-46.75</b>
Hong Kong	<i>Growth Enterprise Market (GEM)</i>	6,696	N.A.	N.A.	7,818	N.A.	N.A.	<b>-14.35</b>
Kuala Lumpur	<i>Second Board</i>	4,208	N.A.	N.A.	5,299	N.A.	N.A.	<b>-20.59</b>
Kuala Lumpur	<i>Mesdaq</i>	203	N.A.	N.A.	47	N.A.	N.A.	<b>335</b>
Osaka	<i>New Market Section</i>	28	N.A.	N.A.	20	N.A.	N.A.	<b>40.72</b>
Singapore	<i>Sesdaq</i>	1,747	N.A.	N.A.	1,650	N.A.	N.A.	<b>5.86</b>
Thailand	<i>Market for Alternative Investment (MAI)</i>	89	N.A.	N.A.	9	N.A.	N.A.	<b>887.21</b>
Tokyo	<i>Mothers</i>	4,128	N.A.	N.A.	<b>5,312</b>	N.A.	N.A.	<b>-22.29</b>
<b>C. Total turnover (US\$ million)</b>								
Deutsche Börse	<i>Neuer Markt</i>	23,866	9,815	33,682	68,670	19,412	88,082	<b>-61.76</b>
London	<i>AIM</i>	2,648	0	2,648	3,500	0	3,500	<b>-24.34</b>
Euronext	<i>New Market</i>	4,470	33	4,503	7,242	80	7,322	<b>-38.50</b>
Hong Kong	<i>Growth Enterprise Market (GEM)</i>	5,639	0	5,639	5,054	0	5,054	<b>11.57</b>
Kuala Lumpur	<i>Second Board</i>	3,869	-	3,869	2,567	-	2,567	<b>50.74</b>
Kuala Lumpur	<i>Mesdaq</i>	0	-	0	1	-	1	<b>-95.03</b>
Osaka	<i>New Market Section</i>	14	0	14	11	0	11	<b>27.52</b>
Singapore	<i>Sesdaq</i>	NA	NA	3,328	NA	NA	1,550	<b>114.68</b>
Thailand	<i>Market for Alternative Investment (MAI)</i>	293	-	293	40	-	40	<b>637.84</b>
Tokyo	<i>Mothers</i>	4,052	0	4,052	2,881	0	2,881	<b>40.67</b>

Source: International Federation of Stock Exchanges (FIBV)

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## Endnotes

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<sup>1</sup> Source: [www.corpgov.net](http://www.corpgov.net).

<sup>2</sup> An example of pension fund related institutions is the CalPERS or California Public Employees Retirement System. CalPERS is the largest U.S. pension fund and the third largest in the world. CalPERS recognizes the good governance is associated with a lower risk and a higher return to the investment of the institution, and actively involves in identifying and investing in companies with good governance practice.

<sup>3</sup> Typically, fund managers actively utilize analysis results in their investment decision process. Hence, fund managers contribute to a strong demand for metrics concerning the value of the companies. Corporate governance structure is a key feature that determines firm value. On a separate consideration, the evidence on whether institutional investors actually participate in corporate governance activities is mixed. While there is strong evidence that institutional investors contribute to (and utilize) corporate governance *resources*, some studies suggest that fund managers in general do not participate in the corporate governance *process*. For example, fund managers might actively participate in the voting process; go to proxy meetings, etc.

<sup>4</sup> OECD (1999), p. 12.

<sup>5</sup> Hong Kong should also have a high stock market to capitalization ratio. However, such information was not available in the IMF database.

<sup>6</sup> This argument is especially valid in U.S. large corporations. Studies have shown that in these corporations the management team as a whole typically owns less than 5% of the equity.

<sup>7</sup> The figures in Table 10 include direct and indirect ownerships by family members. In general, family holding can be arranged by direct ownership by individual members, or through a family trust. In the past decade ownership through a family trust is becoming popular in Asian countries. Since the studies on ownership include both direct (through each family members who might individually own less than 5% and may not be required to be disclosed) and family trusts, the efforts in tracing precise ownership figures involve laborious work which can be subject to underestimation of actual level of ownership (e.g., due to the exclusion of some family member).

<sup>8</sup> Since Table 10 uses market capitalization as the basis of calculation, the percentage of family ownership may tend to be higher since significant family group may control companies of large capitalized companies.