Asian Shadow Financial Regulatory Committee

The Role of Institutional Investors in Strengthening Corporate Governance in Asia

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Early phases of the East Asian miracle were advanced by a corporate structure that emerged from Asian culture and institutions. In Japan, corporations were controlled within networks dominated by a main bank. Korean corporations were organized by corporate groups, each controlled by a charismatic individual with close links to an activist government. Overseas Chinese companies were controlled by families. These corporate structures ensured fast growth through long-term investment strategies that paid less attention to investor returns. The 1997-1998 Asian financial crisis drew attention to the downside of these structures, for they left minority shareholders vulnerable to exploitation by controlling shareholders, e.g., through related party transactions including lending. The crisis was precipitated by the exit of foreign lenders frightened by the high levels of debt that resulted.

The Asian financial crisis was a wake-up call that pointed the region toward Western models and standards of corporate governance. However, we should remain aware of differences between Asia and the West in culture, law and institutions and in the balance of power between government, controlling shareholders, retail private shareholders and institutional investors. For example, in East Asia, institutional shareholders seldom hold controlling blocks of shares and must be counted for all practical purposes amongst the minority shareholders. The West holds that the only role for government in corporate governance is to ensure a level playing field. This presumes a legal and institutional environment that allows minority shareholders to defend their rights. It also presumes that they view themselves as long-term investors, rather than as asset traders. These conditions often do not apply in Asia, so the playing field can still be dominated by corporate networks or controlling shareholders.

In Singapore and Malaysia, provident/pension funds hold a large proportion of shares, so governments already have the legal right to act on behalf of the pensioners whose assets are held in these funds. The boards of these funds should assign members to monitor individual companies and to provide constructive criticism of their strategy and performance. For companies where the provident funds have a large stake, the government could appoint independent directors, with the mandate to ensure transparent accounting, and good corporate governance to raise long-term returns for retirees.

According to the World Bank, about 2/3 of companies in East Asia outside China has a controlling shareholder. In China, a majority of companies have a controlling block of shares held by state-controlled entities. In these contexts, it is important to ensure that minority shareholders are represented. One way to ensure this is to exclude controlling shareholders from voting for independent directors.

We question whether amateur part-timers can carry out duties of independent directors effectively, as Asian businesses become more complex, more expansive, and more global. Company directorship should be recognized as a profession with entry qualifications, ongoing certification, support staff, commensurate remuneration and professional liability.

Asian governments should promote shareholder activism by legislation, if needed, that facilitates class action suits, e.g., by adopting the no-fault rule in legal actions by shareholders against corporations, and by allowing lawyers to act for classes of shareholders on the basis of contingency fees.

A major force for good corporate governance is the shame that follows public disclosure. In some Asian economies, public disclosure can be muffled by personal pressures and even threats. Foreign institutional investors are likely to be better insulated against these pressures. Therefore, they should be encouraged to invest for the long-term, e.g., by tax incentives, so that they would play a catalytic watchdog role. Local governments and regulators should solicit their views on the governance of particular companies.