NUS National University of Singapore

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Culture and corporate governance

Corporate culture, like ethics, may seem like something soft and fluffy that you would hug, but it is critical for good governance. **BY MAK YUEN TEEN**

AS another review of the Code of Corporate Governance is in progress, it is worth reminding ourselves that while rules are important, they are only a small part of what really drives good corporate governance and sustains continuing improvement. What is arguably more important is what we can call "culture".

The Asian Corporate Governance Association (ACGA), in its *CG Watch* reports, considers the "CG culture" – a culture whereby companies, boards, investors, intermediaries, professional bodies, media and other market players drive corporate governance improvements – as one of the five key areas of corporate governance.

According to the 2016 and previous editions of *CG Watch*, CG culture is almost always the weakest corporate governance factor across different countries, compared to CG rules and practices, enforcement, political and regulatory environment, and accounting and auditing. For Singapore, CG culture scored well below the other factors.

ACGA also reported a big difference in CG culture between Australia (the only non-Asian country it covered for comparison purposes) and Asia, and warned that the "controlled and hierarchical management-shareholder communication system in Asia may become, if it does not evolve, a significant impediment to corporate governance and capital market development in Asia." (BT, Sept 30, 2016). The CG Watch 2016 specifically identified "CG culture" as the top strategic priority for improving the corporate governance ecosystem in Singapore, followed by "enforcement".

The low scores for CG culture and its glacial rate of change over the years across countries suggest that improving CG culture is considerably more difficult than improving other areas.

What might influence the CG culture in a country? First is societal culture itself – what the Oxford Dictionary defines as "the ideas, customs and social behaviour of a particular people or society". An aspect of societal culture which may be particularly relevant to corporate governance is how hierarchical or egalitarian a society is.

Solomon and Schell's (2009) book on managing across cultures defines hierarchy-egalitarianism as: "The way individuals view authority and power, how much deference one gives to people in authority, whether people are entitled to express themselves, and how empowered they feel to make independent decisions and take the initiative. It is also one's relationship to power and authority. Are people in authority better or have they earned that status by merit, and is it open to others with the same degree of effort?"

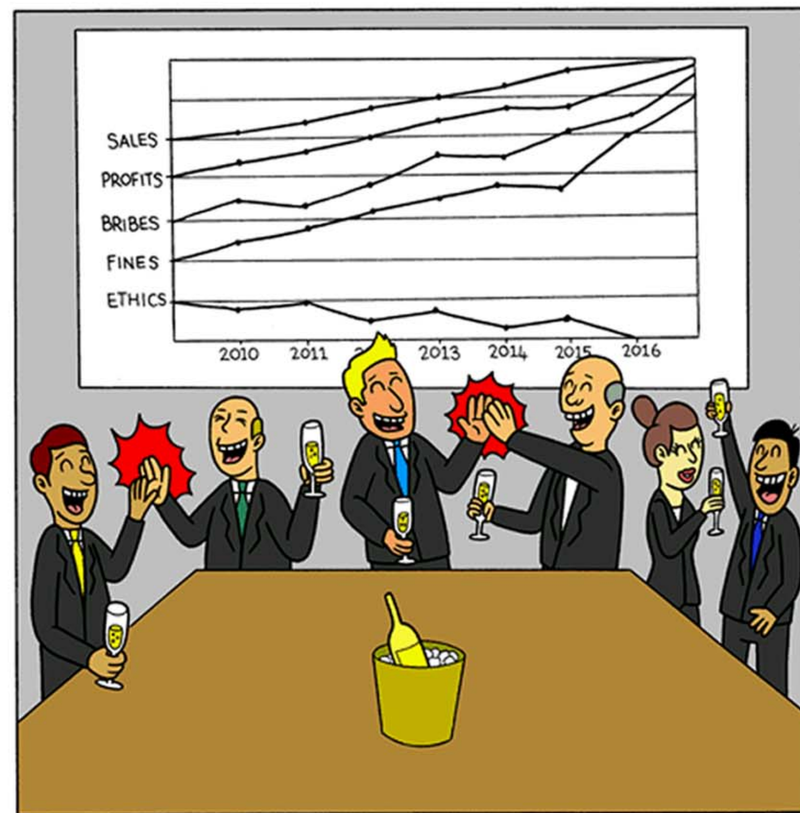
Based on Solomon and Schell's work, Asian countries and economies generally fall into the hierarchical end of the spectrum, with Brunei, India, Indonesia, Japan, Malaysia, Pakistan and South Korea among those in the group considered most hierarchical, and China, Hong Kong, Philippines, Singapore, Taiwan, Thailand and Vietnam in the second most hierarchical group. In contrast, Australia, Canada, Denmark, Israel, Netherlands and New Zealand are in the most egalitarian group.

While corporate governance is about oversight from the top, it requires a willingness to question and challenge those who may be higher up in authority or have greater stature in society.

In hierarchical cultures, directors may be less inclined to offer dissenting views from the chairman. Last year, I participated in a discussion overseas about audit quality and part of that discussion was about culture and professional scepticism. An important point that emerged was that the hierarchical culture in that country – where different "titles" are conferred on individuals signifying their status – can be a challenge to the exercise of professional scepticism.

Whistleblowing systems are also likely to be less effective as a deterrent against unethical conduct by senior management in a hierarchical society. For example, in scandals involving Japanese companies such as Olympus and Toshiba, the reluctance of employees to speak out against misconduct or unrealistic targets set by senior management was attributed to the hierarchical nature of Japanese corporate culture.

I do not mean to say that a hierarchical culture is always bad. However, it does pose some challenges for good corporate governance. Can anything be done to minimise the potential debilitating effects of a hierarchical culture on corporate governance? I think so. First, those appointed to leadership positions need to be sensitive to the difficulties others may face in speaking up. I have seen chairmen of boards and committees who are quite skillful in doing so. One of the most respected former civil servants here said he "leads from the back" and encourages others to give their views first rather than asserting his views too early in the decision-making process.



Source: Mak Yuen Teen and Chris Bennett, 'Guardians of the Capital Market', 2016. Reproduced with permission by BT.

A contrary example is a chairman who immediately states his views on a decision at hand, making it awkward for others to offer dissenting views. Effective chairmanship is an important quality, and arguably even more so in a hierarchical culture.

Having people from other cultures may also help. At Olympus, it was the British-born CEO Michael Woodford who blew the lid off the scandal in the Japanese company. I remember an international director of a government-linked company here who said that one of his contributions was that he did not feel awkward about asking questions that some of the local directors may feel awkward asking.

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However, a word of caution about stereotyping. Some years ago, a Caucasian resident here contacted me through a mutual friend and asked whether putting himself up as an independent director candidate in a boardroom tussle, involving the removal of a chairman who is an "establishment figure" here, will cause him to "step on some toes". It was strange asking someone who has been told that he has bruised many toes and he seemed to be thinking like a typical "*kiasi*" Singaporean.

CG culture is also affected by what may be called the institutional environment – the independence and quality of "institutions" involved in promoting good corporate governance. Jamie Allen, secretary-general of the ACGA, in commenting on the superior CG culture in Australia, mentioned "companies talking to investors, investors being active, training of directors and accountants, strong investor bodies and strong civil society".

Today, many Asian countries have established director institutes, and the importance of training or professional development of directors is generally well recognised by regulators and investors. However, among directors themselves, there is often considerable apathy. Directors often go for training only if mandated to do so or attend only the minimal training necessary to satisfy regulatory requirements.

In contrast, in some developed markets, professional development of directors is more structured and taken more seriously by directors themselves. As for investor activism, shareholder bodies and institutional investors in Asia have traditionally preferred closed-door engagements because they believe that voicing concerns publicly will cause a loss of "face" and make companies more resistant to change. In contrast, the Malaysia's Minority Shareholders' Watchdog Group is rather public and forceful in its activism and is well respected for its independence.

It attends more than 300 shareholder meetings each year to ask questions, by buying 100 shares in each of these companies, and also regularly raises issues publicly through the media or through its newsletter. David Webb, who runs a well-followed website in Hong Kong, is as public and vocal a shareholder activist as you can find almost anywhere in the world and, in my view, has been quite effective in holding companies to account.

We also see investors such as BlackRock becoming more willing to engage in public campaigns in Asia, and more public activism by hedge funds and other institutional investors in countries such as Japan and South Korea. These examples of shareholder activism overcoming cultural barriers in Asia are, in my view, a positive development and long overdue.

Nevertheless, the development of strong institutions that can help foster a strong CG culture is still at a nascent stage in much of Asia. This, coupled with the hierarchical society, means that a top-down regulator-driven approach remains the main approach for improving corporate governance.

Regulators can realistically only directly help build a culture of compliance, through setting the right tone and effective enforcement, rather than a culture of performance. They can, however, play a facilitating role in building a culture of performance by supporting the development of strong institutions and encouraging responsible activism, including public activism.

The overall CG culture in a market is clearly important. However, the internal corporate culture of companies also matters and this is something that currently does not receive enough attention in discussions about corporate governance. Corporate culture, like ethics, may seem like something soft and fluffy that you would hug like my ragdoll cat, but it is critical for good governance.

What determines corporate culture of a company are the people at the top and, for many companies in this region, the most important people at the top are the major shareholders, the board chairman and the CEO – those responsible for the control, governance and operations of the company. I call them the "Holy Trinity" of the corporate governance of a company.

While corporate governance codes and rules generally emphasise policies, structures, systems and processes, these must be based on a foundation of having the right people at the top. Companies sometimes have a poor corporate culture hidden behind a veil of policies, structures, systems and processes.

I am reminded of a story shared by a senior internal auditor of a large Singapore Exchange-listed company about the first board meeting she attended some years ago. The board was considering a major transaction and the lawyers, bankers and advisers opined that it ticked all the compliance boxes and was a good business deal.

Somewhat to her surprise, the major shareholder said that it was not sufficient that it was a good deal or that it complied with the rules, but that it should also be good for minority shareholders. That incident confirmed to her that she had joined the right company. When you have a major shareholder with such values, half the corporate governance battle is won.

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