Goverance: giant steps ahead for South East Asia

Most companies are not there yet in terms of having truly effective boards that add long-term value to companies. By MAK YUEN TEEN

Corporate governance reforms in Asian began with the release of the Finance Committee Report on Corporate Governance in Malaysia in February 1999 and the publication of the Malaysian Code of Corporate Governance in March 2000. This was followed by Singapore’s first Code of Corporate Governance, developed by the Corporate Governance Committee and endorsed by the Ministry of Finance, in April 2001. Other founding members of Asian also released codes of corporate governance in the early 2000s – Indonesia in 2001 and Thailand and the Philippines in 2002. They all have since revised their codes. Some other Asian countries have since embarked or are about to embark on their own governance journey.

In charting the path that a particular country takes, it is useful to distinguish between four different phases of the governance journey:

- Awakening
- Awareness
- Compliance
- Performance

The accompanying table shows the key phases and what we see as the key action steps needed and their drivers. The different phases do overlap and can occur concurrently. For example, even if awareness of good corporate governance as a whole is high in a country, it must be ongoing as new companies, directors and other stakeholders participate in the capital markets.

Prior to 2000, corporate governance concepts were quite new in many in the business community in Asia. Codes of corporate governance and other governance rules were quickly introduced to ‘wake up’ docile boards which were often rubber stamps at that time and apathetic stakeholders. Governments and regulators played the key role in this phase. This ‘Awakening’ phase in the five founding Asian member countries was a relatively short one, few years phase that was triggered by the 1997 East Asian financial crisis.

It is often major crises or scandals that got a country into action. For example, the Sarbanes-Oxley Act 2002 in the US springing from the Enron and WorldCom accounting scandals. It caused the US to move from a non-prescriptive, rather pure disclosure-based approach, where regulators general only get involved when companies dis- close their approach to corporate governance rather than dictate their approach, to the highly prescriptive SOX and related changes in SEC, NASDAQ and stock exchange listing rules.

Though past crises, we can also see that the bureaucrats and regulators often avoided addressing the “elephant in the room” in governance reforms. For example, SOX largely targeted the “symptoms” in corporations that were not accounting scandals, such as weak internal controls over financial reporting, threats to audit independence and inadequate whistleblower policies and protections.

Regulators in the “Awareness” phase have tried to move away from the “elephant in the room” that has yet to be satisfactorily addressed by regulators. The controls on market operators and such critical stakeholders have been over-extended. This remains the biggest Achilles heel of corporate governance for many countries around the world. Making incremental changes to criteria used to determine “independence” of directors have had only a marginal impact on the true independence of directors.

The “Awakening” phase is generally followed by the “Awareness” phase, during which stakeholders, like industry and professional bodies, often in collaboration with regulators, organise conferences and training programs to raise awareness of corporate governance. The focus here is very much on helping the business community understand the new corporate governance landscape and rules.

I think it is fair to say that the original five Asian members of IFORS, Malaysia, the Philippines, Singapore and Thailand are all past the “Awakening” and “Awareness” phases on the whole.

The next phase is the “Compliance” phase, where the emphasis is to ensure that companies and individuals comply with corporate governance rules and guidelines. The key action step is enforcement, by regulators and investors. Here, the original five Asian members arguably differ substantially. Although compliance is important, this is where the “box-ticking” approach has its roots. I believe that most companies and boards not only in this region, but around the world, have not moved beyond mere compliance when it comes to corporate governance.

Moving from the “Awakening” to the “Awareness” and then to the “Compliance” phases is not without their challenges. It is like going on a treadmill and the incline gets steeper and the speed faster, but many companies and boards are able to move towards compliance with rules and regulations with some effort. However, moving to the “Performance” phase – where boards are truly effective in enhancing long-term value of companies – is a completely different proposition. It is like going from the treadmill to running the marathon.

The reason why moving to the “Performance” phase is very difficult is that the key action step necessary is culture change, which has to be largely driven by boards themselves. The bi-annual survey of corporate governance in Asia published by the Asian Corporate Governance Association (ACGA), which evaluates countries based on corporate governance, rules and practices, enforcement, political and regulatory environment, disclosure and transparency and corporate governance culture, has found that most countries consistently score much lower on corporate governance than culture than other factors. ACGA defines “corporate governance culture” as “corporate governance of professional firms, the media and other making voluntary efforts to improve corporate governance. Regulators have a far more limited role in driving corporate change. However, they can facilitate it by changing their approach to regulation as follows:

- Focusing less emphasis on constant and minor technical violations, which rarely creates more "box-ticking" without substantive changes.
- Adopting a more principles-based approach, which focuses on the desired outcomes rather than specific "best practices".
- Making a small number of bold changes in rules to promote culture change in boards through the introduction of fresh talent and perspectives onto boards.
- Investors can also play a role in fostering culture change by intelligent voting of their shares to support board renewal and holding boards to account.

While regulators and investors can exert external pressure to promote culture change, the most important driver for culture change is boards themselves. To do so, they need to trust their directors, look for leaders with less focus on training targeted at mere compliance or how to reduce liability.

- Focusing less on just legality or formality of board procedures, and more on ethics and board effectiveness issues.

- Improving the search and nomination process and succession planning for directors to ensure that they are the right people for the right jobs.

- Improving professional development of their directors with less focus on training targeted at mere compliance or how to reduce liability.

- Acting on properly-executed reviews of board effectiveness by using such reviews to drive board renewal, succession, search and nomination processes.

Most companies are not there yet in terms of having truly effective boards that add long-term value to companies. The rest of the journey is going to be far more difficult than what has gone on before and some sharp turns will be needed to keep up.

The writer is associate professor at the NUS Business School and was a member of the first corporate governance committees in Singapore that developed the first Code of Corporate Governance and revised the Code in 2005. This article is adapted from a speech titled “Governance: Next Steps for South East Asia” given by the writer at an overseas corporate governance conference in 2014.