CORPORATE GOVERNANCE IN ASIA

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This study examines the state of corporate governance in some countries in the Asia-Pacific region. Since the early 1990s, corporate governance has been receiving increasing attention from regulatory bodies and practitioners worldwide. A key aspect of improving corporate governance in the region is that improved investor protection and more transparent information will enhance the development of local capital markets and promote foreign investment to provide funds for long-term economic development. The authors suggest that individual countries should first focus on improving national standards of regulation and corporate practice rather than attempt to reach a common set of matrices from the start. When appropriate governance standards are in place in individual countries, codes of best practice could then be integrated into a consistent framework for all countries to develop more regionally integrated capital markets.

Corporate governance refers to the system through which the behaviour of a company is monitored and controlled. The significance of corporate governance is that in modern economies large corporations are typically associated with a division of labour between the parties who provide the capital (i.e., shareholders) and the parties who manage the resources (i.e., management). Conflict of interest among the two groups might lead to insufficient monitoring of the executive, suboptimal levels of investment in the 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.

Interest in corporate governance by policy makers in developed countries had grown significantly by the early 1990s. Three issues were addressed and studied following a general concern with the overall efficiency of the corporate world. First,

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did corporate directors and managers receive a clear allocation of responsibilities and were they monitored in an appropriate manner? Second, did the accounting profession deliver a 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 paid higher and higher compensation packages, some amidst a significant decline in the firm's performance?

The first large-scale official efforts in the OECD countries resulted in the publication of the Cadbury Report (1992) in the United Kingdom of Great Britain and Northern Ireland. The objective of the Cadbury Committee was to investigate how large public companies should adopt corporate governance guidelines with a focus on the procedures of financial report production and the role of the accounting profession. Issues included the role of the board of directors, standards of financial reporting, accountability of auditors, and directors' pay.

A follow-on study was carried out in the United Kingdom with the Greenbury Report (1995) which 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.

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: (a) the role of directors; (b) directors' compensation; (c) the role of shareholders; and (d) accountability and audit.

Separate efforts were made in other OECD countries to address similar issues as in the various studies carried out in the United Kingdom. In general, these efforts addressed the notions that decisions 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 operations and, hence, the value of the firm.

The foundation of corporate governance concerns lies in the ownership structure of firms listed in 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 of America suggest that such corporate insiders hold on average about 5 per cent of the shares of the company. It is not clear how these parties will make decisions consistent with the interest of shareholders as a whole.

OECD listed companies are also characterized by significant ownership by institutional investors. The online corporate governance resource centre <www. corpgov.net> states that institutional investors hold about one half of all listed corporate stock in the United States and about 60 per cent in the largest 1,000 corporations. In capital markets outside the United States, the top 25 American pension funds account for 42 per cent of the foreign equity held by all American investors.[1]

Table 1 provides pertinent international data of institutional holdings of equity. The table shows that in the period 1990-1991, the holdings by institutional investors, as defined by financial institutions including banks, insurance companies, pension funds, and investment companies, were, respectively, 40 per cent in the United States, 61 per cent in the United Kingdom, 20 per cent in Germany, and 47 per cent in Japan. Pension funds represent the most significant group of institutional investors. In the United States pension funds represent 25 per cent of all equity. This figure is 30 per cent in the United Kingdom. In Germany and Japan, insurance companies represent a large group of institutional investors, 11 per cent and 17 per cent of all equity. 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 programmes such as ERISA in the United States.[2]

The active involvement of institutional investors implies that fund managers (who are agents of fund beneficiaries) demand information matrices through which they can make their investment decisions and an assurance of proper monitoring of public companies.[3] The globalization of capital markets presents a trend in the pursuit for a common set of policy guidelines and codes of practice. At a higher 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.

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[1] Source: <www.corpgov.net>.

[2] An example of pension fund related institutions is the California Public Employees Retirement System (CalPERS). CalPERS is the largest American pension fund and the third largest in the world. CalPERS recognizes that good governance is associated with lower risk and a higher return on the investment of the institution, and actively involves in identifying and investing in companies with good governance practices.

[3] Typically, fund managers actively utilize analysis results in their investment decision process. Hence, fund managers contribute to a storing demand for analysis 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.

Table 1. Institutional ownership structures in selected OECD countries, 1990-1991

	United States	*United Kingdom*	*Germany*	*Japan*
A. Institutional investors				
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
Subtotal	**39.80**	**60.80**	**19.50**	**47.00**
B. Other investors				
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
Subtotal	**60.20**	**39.20**	**80.50**	**53.00**
TOTAL	**100.00**	**100.00**	**100.00**	**100.00**

Source: Kester (1997), p. 234.

Over the last few years different country groups have been establishing their own common set of benchmarks for corporate governances, for instance, 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. Members of APEC considered that the OECD guidelines have the problem of ‘one size cannot fit all’ and some may be applicable to some, but not all. APEC countries therefore called upon the Pacific Economic Cooperation Council (PECC) to develop a set of guidelines which were in line with the OECD principles. The APEC guidelines can be considered as a middle step for emerging markets to achieve a better practice of good corporate governance. This set of guidelines forms the standard for individual Governments, regulatory bodies and professional bodies to develop their agendas and with a view to setting up acceptable codes of practice.

I. INTERNATIONAL STANDARDS AND OECD PRINCIPLES

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 within which the corporations are operating. One such classification is the Anglo-Saxon model (that applies to the United Kingdom and the

United States) and, the other, the Rhineland model (that applies to Germany and some other continental European countries).

The Anglo-Saxon model of governance is characterized by widespread shareholding of equity and a stress on financial objectives by 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 that board members and executives work to maximize shareholder wealth. Shareholders are viewed as the "risk takers" of the company.

The Rhineland model is characterized by a significant holding by a parent company and outside shareholders represent a smaller portion of the equity. This model is based more on a "socially correct" market economy. In fact, individual companies within a particular company group can be viewed as an "internal market", both in terms of financial and other resources such as labour and intellectual properties. Hence, cooperation is stressed. Shareholders in this system are generally stable partners and relatively longer-term investors as compared with the Anglo-Saxon model. Shareholders are viewed as "partners" of the company.

The Rhineland model also presents a difference in the structure of the board of directors. German companies, for instance, are comprised 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 day-to-day strategies (a broadly similar system is present in the Japanese corporate system).

The OECD principles cover five aspects of governance: (a) the rights of shareholders; (b) the equitable treatment of shareholders; (c) the role of stakeholders in corporate governance; (d) disclosure and transparency; and (e) the responsibilities of the board. Table 2 provides a summary of the main issues in each of these five areas.

II. CORPORATE GOVERNANCE IN SOME ASIAN COUNTRIES

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 that particular country. The OECD also recognizes that corporate governance should be an evolutionary process and be adjusted as new issues emerge in the capital markets.

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 corporate governance guidelines and practice codes be designed and adopted by each constituent country. In the end, corporate governance should produce an environment within each country that corporations identify with and can adhere to in their decision-making processes. In Asian countries, the interest

Table 2. Summary of OECD principles of corporate governance

Rights of shareholders	1. Recognition of basic shareholder rights 2. Shareholders have the right to participate in decisions concerning fundamental corporate changes 3. Voting rights of shareholders 4. Disclosure of disproportionate voting rights of certain shareholders to obtain a degree of control 5. Markets for corporate control should be allowed to function 6. Shareholders should consider the costs and benefits of exercising their voting rights
Equitable treatment of shareholders	1. All shareholders of the same class should be treated equally 2. Insider trading and abusive self-dealing should be prohibited 3. Board members and managers should disclose material interests
Role of stakeholders	1. Assure that rights of stakeholders are protected by law 2. Stakeholders should have the opportunity to obtain effectiveness redress for violation of their rights 3. Permit performance-enhancing mechanisms for stakeholder participation 4. Stakeholders should have access to relevant information in the corporate governance process
Disclosure and transparency	1. Scope of material information to be disclosed 2. Information should be prepared in accordance with high accounting standards 3. Annual audit should be conducted by an independent auditor 4. Fair, timely and cost-effective means of disseminating information
Responsibilities of the board	1. Board members should act on the best interest of the company with due diligence and care 2. The board should treat all shareholders fairly 3. The board should ensure compliance with the law and take account the interest of stakeholders 4. Definition of key functions of the board 5. The board should exercise objective judgment independent from management 6. Board members should have access to accurate, relevant and timely information

Source: OECD Principles of Corporate Governance (1999).

in corporate governance has been sporadic but has stepped up in the late 1990s following the 1997-1998 crisis. Subsequent to the outbreak of the Asian currency crisis in 1997, the flow of capital from foreign investors suddenly dried up, leading to intense liquidity problems in local capital markets and a real impact on the economy due to insufficient capital and investor apprehensions.

From a national perspective, the promotion of good corporate governance serves two important purposes in the development of local and regional capital markets. First, local equity markets play a central role when there is a lack of foreign capital. Good corporate governance promotes the development of local equity markets and reduces the reliance on foreign debts. Second, institutional investors usually constitute the majority of foreign investors. Improved corporate governance provides a higher level of investor confidence from international investors and thus increases the stability of local equity and other capital markets. There are thus significant benefits flowing from good governance to the Asian corporate setting. The most significant is the reassurance of investor confidence, especially for foreign institutional investors. In the long run, good governance leads to the stable development of local capital markets since foreign capital becomes more "patient".

Studies have stressed several factors that contribute to an environment that nurtures good governance: (a) laws that define and protect private property rights; (b) laws that protect and enforce contractual rights, such as contracts between lenders and borrowers; (c) laws that protect against fraud and unfair and deceptive trade practices; (d) centralized banking laws; (e) bankruptcy laws; and (f) a competent, ethical, politically independent judiciary. Other studies suggest that sound corporate governance enhances stable and low cost capital formation. To preserve this benefit, measures taken should include (a) corporate management to prevent fraud, waste, and inefficient use of corporate assets; and (b) disclosure of relevant information using consistent and comparable accounting and auditing standards.

Value of good corporate governance

Studies have provided evidence in support of the 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 addressed to a large group of institutional investors in each of the economies studied to see if the investors were willing to pay a premium for good governance and if yes, the magnitude of the premium. Table 3 provides a summary of the key results in the McKinsey study. 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 per cent of the investors included in the study were willing to pay a premium for well-governed companies while 81 per cent were willing to pay a premium for well-governed companies in Europe and 89 per cent in Asia. These numbers provide a clear indication of the 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 improvement in that the percentage of investors that were willing to pay a premium for well-governed companies decreased in Asia in the 2002 survey. With regard to the magnitudes of premiums that investors were willing

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

Panel A – Investors willing to pay a premium (per cent)

Region	*2002 (per cent)*	*2000 (per cent)*
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.
Average	**76.2**	**83.5**

Panel B – Average premiums of those investors willing to pay a premium (per cent)

Country/economy	*2002 (per cent)*	*2000 (per cent)*
A. OECD countries		
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
Average	**14.6**	**19.2**
B. Non-OECD countries/economies in Asia		
Indonesia	25.0	27.0
Republic of Korea	20.0	24.0
Malaysia	22.0	25.0
Thailand	20.0	26.0
Taiwan Province of China	19.0	20.0
Average	**21.2**	**24.4**

Source: McKinsey 2002.

to pay, it appears that there is a pattern that the value of good corporate governance is higher for economies where the quantity and quality of information available to investors is inadequate. For example, in 2000, the average premium in OECD economies was 19.2 per cent, compared with the average premium of 24.4 per cent in non-OECD Asian economies. The highest level of premiums was prevalent in Indonesia (27 per cent) and Thailand (26 per cent), both countries heavily affected by the withdrawal of foreign investment capital during the Asian currency crisis of the late 1990s. In 2002, the average premium for OECD economies was 14.6, compared with the average premium of 21.2 per cent in non-OECD Asian economies. We observe that there was some improvement in both OECD and non-OECD economies in Asia on the average premiums of those investors willing to pay. The highest level of premiums still applied to Indonesia (25 per cent) and Malaysia (22 per cent). The premium for Thailand had declined to 20 per cent, possibly due to slow progress with corporate restructuring in the post-1997 period.

Convergence and divergence of Asian codes

Given the common awareness and recognition of the benefits of sound corporate governance, many factors exist that stimulate the convergence of corporate governance codes with international standards. 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

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 – the Republic of Korea also made audit committees mandatory for the listed subsidiaries of the top 30 conglomerates

There are other examples of divergence, including:

- The "stakeholder" concept: some countries (China, the Republic of 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 context of governance

- 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 a two-tier style
- Different legal systems: Singapore, Malaysia and Hong Kong, China have Anglo-Saxon legal systems, whereas other economies have a variety of roots in their legal systems
- Scope of an economy's practice code: Both Singapore and Hong Kong, China have small codes that are limited in scope. The latter's code is about a page and a half long and is extremely general. Singapore's current code is of similar length and only focuses on audit committees. At the other end of the scale is the new code from the Republic of Korea, which runs to about 40 pages and covers each aspect of governance comprehensively.

III. CHARACTERISTICS OF ASIAN CAPITAL MARKETS

In many aspects, Asian equity markets are very different from major equity markets in the developed, western countries. Characteristics include smaller capitalization, smaller size of capital raised, relatively infrequent turnover and a concentration of ownership. These characteristics have a bearing not only on how corporate governance standards can be raised but limit the impact of reforms on the overall nexus between investors and the development of the economy.

Market capitalization

Table 4 presents summary information for market capitalization of 7 major stock exchanges of OECD countries (including Japan) and 10 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. The largest two stock exchanges as at end-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 accounted for US$ 11.1 trillion total capitalization, or 48.6 per cent of world capitalization. The combined capitalization of NYSE, NASDAQ, Tokyo, London, Frankfurt, Euronext, and Toronto was US$ 17.7 trillion, or 77.5 per cent of world capitalization. Within the set of Asian (plus Australia) stock exchanges, Hong Kong, China was the largest with a capitalization of US$ 463 billion, followed by Australia (US$ 380 billion). Other relatively large exchanges were Taiwan Province of China (US$ 261 billion), Republic of Korea (US$ 216 billion), and Kuala Lumpur

Table 4. Market capitalization of domestic shares (millions of US dollars)

Exchange	*End 2002*	*End 2001*	*Change (per cent)*
A. *Major OECD exchanges*			
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
Subtotal	**17 674 613**	**21 768 203**	**-18.81**
B. *Other Asian exchanges*			
Australia	380 087	375 598	1.20
Hong Kong, China	463 055	506 073	-8.50
Jakarta	30 067	22 998	30.74
Republic of Korea	215 662	194 470	10.90
Kuala Lumpur	122 892	118 981	3.29
New Zealand	21 715	17 736	22.43
Philippines	18 183	20 606	-11.76
Singapore	101 554	117 338	-13.45
Taiwan Province of China	261 311	292 872	-10.78
Thailand	45 406	35 950	26.30
Subtotal	**1 659 932**	**1 702 622**	**-2.51**
World total **	**22 809 564**	**26 904 918**	**-15.22**

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.

(US$ 123 billion). Taken together, the 10 Asian exchanges accounted for US$ 1,660 billion, which was less than the size of the London Stock Exchange.

Capital raised

Table 5 presents information on the amount of funds raised in stock exchanges in selected economies in the years 2001 and 2002. It should be noted that the year 1999 was an exceptionally good year for telecommunications, media, and technology (TMT) stocks, and a significant part of equity raising worldwide was related to TMT

Table 5. Total equity capital raised (millions of US dollars)

Exchange	*2002*			*2001*			*Change (per cent)*
	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
Subtotal			**152 763**			**256 156**	**-40.36**
Australia	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, China	7 499	6 665	14 164	4 964	3 297	8 261	71.46
Jakarta	802	121	923	400	123	523	76.41
Republic of 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
Philippines	709	77	786	139	5	143	448.79
Singapore	0	1 208	1 208	0	857	857	40.94
Taiwan Province of China	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
Subtotal			**43 619**			**26 792**	**58.30**
World total**			**261 984**			**334 813**	**-21.75**

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.

companies. Overall, the year 2002 saw a decrease in equity raising activities. The world portfolio (FIBV total) saw a 21.8 per cent decrease in capital raised. The 7 stock exchanges in OECD member countries (NYSE, NASDAQ, Tokyo, London, Frankfurt, Euronext, and Toronto) experienced a 40.4 per cent decrease in capital raised, whereas the 11 Asian stock exchanges (excluding Japan) experienced a 58.3 per cent increase. As a percentage of total capital raised, the OECD exchanges played a very substantial role in 2002. Total capital raised in the 7 OECD exchanges totaled US$ 153 billion, representing 58.3 per cent of the world total. This proportion had shown a significant decrease from the previous year, in which the 7 exchanges raised 76.5 per cent of all capital raised.

The Asian exchanges also showed a significant increase in capital raised. Total capital raised in 2002 was US$ 43.6 billion, representing 16.2 per cent of the world total. This was also a significant improvement from 2001 in which the same group of exchanges raised 8.0 per cent of the total capital raised in all exchanges. NYSE and Euronext both showed decreases in capital raised. In 2002 a total of US$ 46 billion (or 17.7 per cent of capital raised globally) was raised in NYSE, and a total of US$ 34 billion (or 13.0 per cent of capital raised globally) was raised in Euronext. It should be noted that more than 60 per cent of the funds raised in NYSE were raised by newly listed firms in the form of initial public offerings (IPOs), while a majority of the funds raised in Euronext were raised by already listed firms. In Asian economies, the most significant increase was in the Philippines Stock Exchange, with total equity raised of US$ 786 million compared to 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 the Philippines Stock Exchange, significant growth in capital raised was found in the Kuala Lumpur Stock Exchange (379 per cent) and the Colombo Stock Exchange (361 per cent). On the other hand, the Thailand Stock Exchange showed a decline in the capital raised. 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 economies still lack such capabilities.

Significance of the stock market

Table 6 provides a summary of 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. The sample of six OECD stock markets had a high percentage of the stock market to GDP ratio of 97.9 per cent. The highest ratios were in the United Kingdom (152.2 per cent) and the United States (137.1 per cent). The countries that had lower ratios include Germany (58.1 per cent) and Japan (55.4 per cent). For the sample of 11 Asian member economies, the stock market capitalization to GDP ratio was significantly lower. The average ratio for the 11 was 85.7 per cent. Those with the highest ratio were, respectively, Hong Kong, China (312.8 per cent), Singapore (137 per cent), Malaysia (135.1 per cent), and

Table 6. Significance of stock markets in the economy in 2001 (millions of US dollars)

	Stock market capitalization	*GDP*	*Per cent*
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, China	506	162	312.76
Indonesia	27	153	17.49
Republic of 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 Province of China	293	n.a.	n.a.
Thailand	36	115	31.32

Source: IMF, *International Financial Statistics Yearbook 2001.*

* market capitalization and capital raised in the United States includes Amex, Chicago, NASDAQ and NYSE.

Australia (105 per cent).[4] The countries with the lowest ratios were, respectively, Sri Lanka (8.5 per cent), Indonesia (17.5 per cent), and Thailand (31.3 per cent).

A brief conclusion drawn from the figures in table 6 is that certain non-OECD economies are characterized by relative 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 remains a relatively small representation of the size of the national economy and it was basically a closed market until the late 1980s. The other emerging markets in Asia show a similar pattern of underdevelopment in capital markets. In general, corporate governance develops hand in hand with the capital market system. With relatively underdeveloped capital markets, these economies will

[4] Hong Kong, China should also have a high stock market to capitalization ratio. However, such information was not available in the IMF database.

be faced with additional issues in designing and enforcing the appropriate corporate governance rules.

Stock turnover

Table 7 reports the turnover on the stocks of domestic and foreign companies in 7 OECD stock exchanges and 10 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 per cent decrease. The rate of turnover decrease in the OECD exchanges (6.4 per cent) was in contrast to the increase in the

Table 7. Turnover value (millions of US dollars)

Exchange	*2002 Domestic companies*	*Foreign companies*	*2001 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
Frankfurt	1 110 392	101 909	1 288 481	134 890
Toronto	397 187	238	448 462	401
Subtotal	**23 306 092**	**3 178 633**	**27 359 073**	**4 062 400**
All companies		**26 484 725**		**31 421 473**
Australia	290 946	4 453	241 323	3 139
Hong Kong, China	193 685	257	238 145	212
Jakarta	13 050	0	9 410	0
Republic of 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
Philippines	3 045	48	3 050	79
Singapore	n.a.	n.a.	n.a.	n.a.
Taiwan Province of China	633 226	290	541 491	257
Thailand	41 280	0	30 804	0
Subtotal	**1 811 804**	**6 606**	**1 475 883**	**5 285**
All companies		**1 818 410**		**1 481 168**
TOTAL		**28 303 135**		**32 902 641**

Source: International Federation of Stock Exchanges (FIBV).

* Euronext included Amsterdam, Brussels, Lisbon and Paris.

Asian exchanges (4.4 per cent). The stock turnover in OECD stock exchanges represented 88 per cent of turnover for domestic companies in 2002. The same ratio was 87.1 per cent in 2001 (approximately 12 per cent of shares listed on these exchanges were of foreign companies). The most international stock exchange was the London Stock Exchange, which had 52.8 per cent of all turnover from foreign companies in 2002 (59 per cent in 2001). The other exchanges with a high representation of foreign companies include Germany (8.4 per cent) and NYSE (6.9 per cent).

Asian exchanges, on the other hand, are mostly domestic exchanges. The only exception is New Zealand with 14.4 per cent of turnover accounted for by foreign companies. All other exchanges have less than 2 per cent of turnover in foreign companies. As a group, the ratio of turnover in domestic companies was both 99.6 per cent in 2002 and 2001. Two points are noteworthy. First, most of the 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 per cent of all turnover. This percentage was 95.5 per cent in 2001. NYSE and NASDAQ, the largest stock exchanges, together accounted for a turnover of US$ 17.4 trillion or 61.4 per cent of all turnovers. Asian stock exchanges, on the other hand, accounted for a total of 6.4 per cent of all turnover.

A significant number of investors in stock markets 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. The generalization we can draw from the turnover behaviour 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 become resource-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.

Market depth

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. Market depth is especially significant for foreign investors, who are characterized by: (a) a general lack of knowledge in local, social, political, and cultural factors that might have an impact of the stock market; (b) dominated by institutional investors that rely heavily on indirect research from their brokers; and (c) generally have substantial holdings of equity that might suffer significant losses in the event of a market-wide decline on their portfolio holdings. 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, the average number of transactions, and average value of transactions in these markets. Table 7 reports that in 2002 the sample of OECD stock exchanges had a total turnover of US$ 26.5 trillion, or 93.6 per cent of all turnover in the exchanges represented in the table. Among these figures, an average of 12 per cent of turnover was in the stocks of foreign companies (i.e., listed companies from a country other than the country of the stock exchange).

Table 8. Average amount and value of stock trading

	Average amount traded per day (US$ million)		*Number of transactions per day ('000)*		*Average value of transactions (US$ '000)*	
	2002	*2001*	*2002*	*2001*	*2002*	*2001*
NYSE	40 917.3	42 294.5	2 164.94	1 368.75	18.9	30.9
NASDAQ	28 788.1	44 091.0	2 379.18	2 435.97	12.1	18.1
Tokyo	6 358.7	6 747.6	n.a.	n.a.	n.a.	n.a.
London	15 878.3	17 866.3	151.80	129.09	104.6	138.4
Euronext*	7 797.5	n.a.	253.17	n.a.	30.8	36.6
Frankfurt	4 791.7	5 626.0	290.41	372.58	16.5	15.1
Subtotal	**104 531.6**	**116 625.4**	**5 239.49**	**4 306.40**		
Australia	1 167.6	966.3	55.34	52.52	21.1	18.4
Hong Kong, China	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
Republic of 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
Philippines	12.6	12.7	2.03	2.59	6.2	4.9
Singapore	251.2	284.4	n.a.	n.a.	n.a.	n.a.
Taiwan Province of China	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
Subtotal	**8 111.1**	**7 030.3**	**1 756.66**	**1 506.93**		

Source: International Federation of Stock Exchanges (FIBV).

* Euronext included Amsterdam, Brussels, Lisbon and Paris.

The London Stock Exchange was the most international exchange with US$ 2.1 trillion or 52.8 per cent 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 per cent of turnover.

In the Asian stock markets, total turnover in foreign companies was US$ 6.6 billion, representing 0.3 per cent of total turnover. Only New Zealand had a significant portion of turnover in foreign companies. In 2002, 14.4 per cent of turnover in the New Zealand Stock Exchange was in foreign companies, compared with 13.3 per cent in 1998. All other exchanges had a percentage close to or less than 2 per cent. Table 8 shows that stock trading increased significantly in 2002, both in total value and the number of transactions. The number of transactions increased by 36.8 per cent in OECD exchanges and 15.3 per cent in Asian exchanges. NASDAQ was the most active stock exchange by the number of transactions in 2002. The total number of transactions per day was 2,379,180, representing a 2.3 per cent decrease from the figure in 2001. The average value per transaction was US$ 12,100, or a decrease of 33.1 per cent from the figure in 2001. 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 for institutional investors.

As for the Asian exchanges, most showed a significant increase in both the total trading volume and the number of transactions. 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. 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$ 21,100 in 2002). 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, the Republic of Korea (with 788,770 transactions per day) and Taiwan Province of China (with 690,540 transactions per day) were both heavily represented by local individual investors. 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 matters.

IV. ISSUES IN CORPORATE GOVERNANCE IN ASIA

Regulatory system of stock markets

Table 9 provides an overview of the regulatory bodies and clearing settlement organization for OECD and Asian stock markets. The institutional set-up of the regulatory bodies and the clearing and settlement arrangements provide the framework in which stock trading takes place. Many Asian countries have established regulatory bodies for their stock markets. In addition, many have passed a number of laws with respect to the operations of the capital markets. The objective of setting up the regulatory bodies and enacting the laws has been to facilitate stock trading in the local market. However, such institutional settings have usually focused on the mechanism of stock trading and have given less attention to corporate governance issues such as investor protection.

Family ownership

Unlike the OECD model of diverse ownership and separation of the board (led by the Chairman) and 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. It is conceivable that a number of corporate governance issues that have arisen in the western model do not apply fully in the Asian 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 system of checks and balances between the interest of the major shareholder and that of the minority shareholders. Since directors are elected by the controlling shareholders, it is unlikely that the number of non-executive directors will provide an adequate degree of monitoring of the majority shareholders or be able to exert a strong influence on major corporate decisions. The role of such non-executive directors, however, may serve an advisory purpose in the decision-making process. Another issue concerns executive compensation in closely held companies. The standard argument in the executive compensation literature is based on the view that the management team, in particular the Chief Executive Officer, normally holds a negligible stake in the equity.[5] As a result, conflicts of interest between the shareholders and management could arise. However, in the event that the controlling shareholders also hold major executive positions, the majority shareholders/managers will bear a larger share of the cost of potentially excessive compensation and lack of monitoring of the management team.

[5] This argument is especially valid in large American corporations. Studies have shown that in these corporations the management team as a whole typically owns less than 5 per cent of the equity.

Table 9. Regulatory bodies of major stock exchanges

Exchange	*Supervisory body*	*Clearing & settlement organization*
New York	Securities & Exchange Commission (SEC)	DTCC – Depository Trust & Clearing Corp.
NASDAQ	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, China	Securities & Futures Commission (SFC)	Hong Kong Securities Clearing Co., Ltd.
Jakarta	BAPEPAM (Capital Market Supervisory Agency)	Indonesia Clearing and Guarantee Corporation (PT KPEI)
Republic of 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
Philippines	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 Province	Securities & Futures Commission of China	No independent clearing & settlement organization

Source: International Federation of Stock Exchanges (FIBV).

The difference in the ownership structure has the implication that executive compensation might not be a significant issue as in the case of OECD companies. For example, the major shareholder/manager who singly owns 51 per cent of the equity will have to bear 51 per cent of the wealth effects of corporate decisions. The implication for their personal wealth of excessive compensation and other suboptimal corporate decisions will be much more intense than for the typical CEO in OECD companies who owns a much smaller share of equity. Table 10 summarizes a study on a sample of 1,740 Asian listed companies carried out by *Finance Asia*. This sample covers approximately 78 per cent of companies in the economies 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 per cent.[6] Table 10 shows that approximately 58.0 per cent of all Asian companies (by market capitalization) can be classified as being family-owned. The profile of family ownership is fairly consistent throughout the various countries and economies. Malaysia and Hong Kong, China show the highest degree of family ownership, with 67.2 per cent and 66.7 per cent of total market capitalization controlled by family groups. The lowest level of family ownership is in the Philippines with 44.6 per cent of market capitalization owned by family groups.[7] Table 10 also reports the market value of companies controlled by the top five and top 10 families. The top five families control an average of 27.9 per cent and the top 10 families control 35.6 per cent of market value, respectively. The Philippines show the highest level of control by the top five families with 42.8 per cent. Thus, a very large percentage of the stock market capitalization in the Philippines is in fact controlled by the top five families. The lowest level of control in the top five families is in Taiwan Province of China with 14.5 per cent under family ownership.

Studies in Asian corporate ownership have indicated that if the controlling owner is first generation this is likely to have a significant bearing on 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 risks, his/her interests would be better aligned with the overall value-maximizing objective of the company. In the event that the controlling family members are the second or third generation of

[6] The figures in table 10 include direct and indirect ownerships by family members. In general, family holding can be 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 member who might individually own less than 5 per cent 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 members).

[7] Since table 10 uses market capitalization as the basis of calculation, the percentage of family ownership may tend to be higher since significant family groups may control large capitalized companies.

the family, control of the shares is conceivably more diffused among the various family members. This feature may lead to a number of outcomes. Either the second (or third) generation members are better educated and professionally more trained to further develop the company or they might make a lesser effort to manage the company and attempt to obtain excessive compensation packages. The studies on these intricate issues, however, are still limited and no definitive conclusions are possible.

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.

State and group ownership

Table 10 shows information on State ownership of corporations in Asian economies. Traditionally, certain industries (e.g., banking, telecommunications, etc.) might be heavily regulated and the State may own a controlling stake in the companies in such industries. 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 per cent. The second most significant State ownership is in Malaysia with 13.4 per cent of value under State control. When family ownership and State ownership are both included, the Asian stock exchanges represent approximately 70 per cent of market capitalization under family or State ownership. 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. The corporate governance implication of State ownership is that the Government might

Table 10. Total value of listed corporate assets under family control

Country/economy	*No. of corporations surveyed*	*Share of total market capitalization (per cent)*	*Per cent family-owned (20 per cent + control)*	*State-owned (per cent)*	*Total value of listed corporate assets that families control (per cent)*	
					Top 5 families	*Top 10 families*
Hong Kong, China	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
Republic of Korea	345	76	48.4	1.6	29.7	26.8
Taiwan Province of China	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.

pursue policy objectives (such as infrastructure development) that are not necessarily aligned with minority shareholder interests.

Another significant issue is group ownership of companies in Japan and the Republic of Korea. In Japan the *keiretsu* present a unique closed system of internally monitored corporate settings. This model closely resembles the *chaebol* in the Republic of Korea. The group companies are characterized by interlocking cross-holdings of equity, and outside monitoring is difficult. Until recently, these models had played significant roles in the stock markets in Japan and the Republic of Korea. Studies have suggested both the 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 be diverted 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 mechanisms in case the goals pursued are inconsistent with economic reality. Traditionally, the *keiretsu* and the *chaebol* have been keen to pursue market leadership and revenue generation rather than short-term profit maximization as such. These objectives might not be consistent with minority shareholders' interests when the overall product market could be changing in ways that require rapid adjustments to the business plan for specific products.

Accounting and audit standards

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 developed its own set of accounting standards. As the accounting system involved both objective and discretionary items, it would be challenging to come up with a common basis of comparison across different economies. The accounting systems of Singapore, Malaysia and Hong Kong, China originated from the accounting system in the United Kingdom. These three economies represent the closest set of accounting standards to investors. Other economies have had a different historical development in their accounting and auditing systems. The relevant issues in disclosure include the quantity and quality of information obtained by investors. The objective of accounting disclosure is to provide investors with an adequate level of information to make investment decisions. One potential problem is that firms may only disclose aggregate profit 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 a provision of reserves for doubtful debts, among other discretionary items. The adoption of a different policy on the treatment of such discretionary items can have a significant impact on the net profit figure making cross-country comparisons very difficult indeed.

Second board of stock exchange

Since the market boom of technology companies in NASDAQ beginning in the mid-1990s, the stock exchanges in many countries became 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 funds and develop their operations. There are two main features of the companies that attempt to be listed on 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.

Table 11 summaries the number of listed companies, market capitalization and turnover in the second boards of three European and seven Asian markets. In terms of the number of listed companies and market capitalization, the London AIM stock market is the most significant. It may be of interest to note that in 2002, there were two second boards in Paris, the Second Marché and the Nouveau Marché. There were 372 listed companies (five of them were foreign companies) on the Second Marché with a market capitalization of US$ 45.2 billion. The Nouveau Marché included 111 companies (seven 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.

Among the Asian countries, Malaysia and Singapore were the pioneers in developing their second boards. In 2002, 292 companies were listed on 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. The emergence of second boards in Asian countries presents 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 typically 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 interpret 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 in launching 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. Second boards also present a positive message to enhancing corporate governance. In

Table 11. Second boards of stock exchanges

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

Source: International Federation of Stock Exchanges (FIBV).

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.

Legal system and enforcement

The Asian stock exchanges have 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 coherent framework of laws governing stock dealing and corporate governance might not be immediately recognizable or available. More importantly, there is a lack of clarity in individual member countries in the areas of enforcement and jurisdiction of certain activities that can lead to a negative impact on minority shareholders. Such activities include illegal practices such as undisclosed related-party transactions, self-dealing (of shares), insider trading and bribery. 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 have 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 pursue in most Asian jurisdictions.

An exception can be found in the Republic of 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 corporate insiders in the Republic of Korea. Should more efficient enforcement be available, the threat of potential legal actions would almost certainly promote effective corporate governance. 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, China. Traditionally, insider-dealing cases were handled by a semi-official Insider Dealing Tribunal with limited jurisdiction and involved a lengthy process. In 1999 the Government of Hong Kong, China 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 generated a significant reaction from the investment community. One possible scenario is that international investment companies might have directors overseas and appoint an arms-length operation in Hong Kong, China. The legal liability under the proposal would be significant enough to deter international investment companies from setting up their operating arms in Hong Kong, China. As a response to the reactions, the law was subsequently revised, including leaving the burden of proof to the SFC.

One point worth noting is that unlike the OECD markets in which much of the basic protection for investors is offered by their legal systems and enforcement mechanisms, the Asian markets are characterized by a still developing set of institutions and laws that in theory offer similar protection. As the systems are still evolving it is important to ensure that the legal framework includes the right balance between enforcement and flexibility for both business managers and regulators.

V. CONCLUSION AND RECOMMENDATIONS

This paper represents an initial step in analysing the state of development of corporate governance in several economies of the Asia-Pacific region in the context of the benchmarks offered by standards prevailing in the OECD countries. The paper has attempted to provide a broad evaluation of the major aspects of corporate governance in Malaysia, the Republic of Korea, Thailand and Hong Kong China. 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. This study observes that since the late 1990s many Asian countries have made strenuous efforts to draft their corporate governance codes of practice and have attempted to enhance their corporate governance standards. The ultimate goal of corporate governance is to monitor the behaviour of the board in making management decisions that are in alignment with general shareholder interests. Since the corporate finance environments differ widely across the various Asian countries with respect to legal, regulatory, economic, social and cultural factors, it is obvious that a single standard would not apply to all Asian countries.

Given this background, there are two issues concerning the development of corporate governance practices: enhancement of standards within each country and convergence of standards over time across different countries to integrate national markets in this area. The overall view is that the two issues should be dealt with simultaneously. On the operational side, however, we are in favour of the view that each individual country should work to step up its own standards before a unified Code of Practice can be applied. We note that there is a fundamental difference in the corporate setting between OECD and Asian economies 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 and control. In many Asian economies, family control is a common phenomenon and the majority shareholders play a key management role in the company.

Based on this difference, we distinguish that in the OECD model the primary requirement is monitoring corporate management that often has insignificant ownership of the relevant firms' 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. Another major distinction between OECD and Asian economies is in the degree of participation by institutional investors. In OECD countries, institutional investors hold a substantial portion of publicly traded equities and have a strong interest in timely and accurate information and assurance of good corporate governance practice. In Asian countries, however, institutional investors typically represent a small portion of stock market activities. Corporate managers hence may not see an immediate need to impose corporate governance policies. Studies have suggested that there is a demand for good governance practice and good governance could be rewarded by a premium paid by investors. On macroeconomic considerations, good corporate governance will contribute to the stability of the local equity market since investors, in particular foreign institutional investors, will have a greater interest to commit long-term funds to the local market. Such a commitment will be beneficial to long-term economic development in Asian countries. On the basis of the foregoing our recommendations are the following:

Short-term recommendations

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. The following measures to reinforce fair and accurate information disclosure would be relevant:

- Accounting boards and the audit profession should review the standard and format in which financial information is disclosed. Efforts should be made on a country-by-country basis and also on a regional basis since the reporting format can deviate fairly substantially across different countries.
- 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.
- 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 so that investors can have a reasonable understanding of the meaning of the information.

- We suggest that external auditors should take a more active role to reinforce the auditing profession and stress the areas in which investors should take note.

The current status is that many Asian countries have adopted governance guidelines and codes of best practice. However, it remains to be seen if listed corporations can, or will, follow these guidelines and codes. An effective means to facilitate the adoption of these practices is to have the regulatory body that would require corporations' compliance to these practices. Also, the regulatory body should have the power to enforce such practices in listed companies. Regulators should take a consistent standard to apply to all listed companies so that corporate managers can identity with the new guidelines.

Medium-term recommendations

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 programmes so that good governance becomes a common practice in the investment community.

Studies on corporate governance issues. There is a common pattern of an inadequacy of case studies on the abuse of the existing governance rules. Owing to 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 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 programmes.

Long-term recommendations

High-level discussions 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 is present. We suggest that high-level forums and conferences on corporate governance be organized on a regular, i.e., annual, basis. These activities will form a major component in building awareness and a positive culture for corporate governance.

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