Advancing Corporate Governance Reform in Asia

25 February 2002

For decades, Asia's rapid economic growth served as a model for other developing economies. The Financial crisis that devastated the region in early 1997 shocked policymakers and business leaders around the globe. Five years later, much of Asia is still in recovery. Prior to the crisis, corporate governance was viewed by many in Asia as irrelevant, dismissed as a concern for more advanced (and largely Western) economies to consider at their leisure. Today, "corporate governance" verges on becoming a household word, not only in those economies hardest hit by the crisis, but throughout Asia. The key to a sustained recovery lies in addressing the structural defects at the heart of the crisis. Government guarantees, both implicit and explicit, combined with interlocking ownership structures and political improbity to encourage over-lending, and particularly, over-investment in projects that were excessively risky or likely to produce marginal returns. Resistance to reform efforts has been strong in many quarters, but there is room for much hope, as well, with the emergence of domestic champions of corporate governance reform.

On 25 February 2002, the APEC Study Center and The Asia Foundation, together with the Program in International Economic Policy, School for International and Public Affairs, held a half-day panel discussion, presenting three speakers whose combined expertise reflects the diversity of approaches pursued in promoting reform. Each discussed recent developments in corporate governance reform, the origins of systemic problems, on-going initiatives, and the main challenges to reform in the Philippines, China, and Korea, respectively. The program was organized and moderated by Professors Merit E. Janow, Professor in the Practice of International Trade; Director, Program in International Economic Policy; Co-Director, APEC Study Center, School of International and Public Affairs, Columbia University; and Hugh Patrick, Director, Center on Japanese Economy and Business; Co-Director, APEC Study Center. Excerpts of their presentations are presented below, accompanied by highlights of intra-panel and audience exchanges.

Dr. Estanislao, Professor Jang, and Dr. Tong were in the United States to participate in a week-long program of meetings and events in New York, Washington, DC, and San Francisco, sponsored and organized by The Asia Foundation. This program was part of the Foundation's on-going Asian Perspectives series, through which Asian experts from the public, nonprofit, business and academic arenas are invited to the United States to provide in-depth perspectives of critical developments in Asia. For more information, please contact Ms. Rudi Jeung, Assistant Director/Washington, at rjeung@dc.asiafound.org.

Headquartered in San Francisco, The Asia Foundation works with partners from the public and private sectors in the Asia region to support, through grants and other programs, the development of institutions, leadership, and policy in four broad program areas: governance and law; economic reform and development; women's political participation; and international relations.

Co-sponsored by: The Asia Foundation; Program in International Economic Policy, School for International and Public Affairs, Columbia University

FRANCK WIEBE

Chief Economist and Director,
Economic Reform and Development Program,
Asia Foundation

Three years ago, when The Asia Foundation first began considering corporate governance reform as a priority program area, I was often asked why the Foundation should take up this particular issue, given the wide array of other social, economic and political problems in Asia. The phrase "corporate governance" evoked images of boardroom battles of little consequence to broader society.

One effect of the recent events at Enron is that there exists today a much better understanding of how management decisions may have far-reaching implications.

In Asia, too, corporate governance is not just a problem that relates to shareholders. It is also a question of the perceptions of corporate governance problems, how these can impede investment and lead to problems related to economic growth, job creation and poverty alleviation. The reality is that when entire national systems are characterized by problems and by uncertainty, this can have implications that effect broader society.

Today, conversations about corporate governance typically focus on the magnitude of the problems. Particularly with regard to Asia, American attention is usually focused on the stagnation in Japan and the seemingly intractable problems that first emerged with the Asian financial crisis more than four years ago.

These problems are real, but for today I have asked our three guests to focus on the other side of the story—the reforms that have taken place and the work that they are currently engaged in to advance corporate governance reform. I hope that you will get from our three speakers a deeper understanding of the state of corporate governance in Asia.

JESUS ESTANISLAO

Chairman,
Foundation for Community Building in the Asia Pacific;
President and CEO,
Institute of Corporate Directors

In most of East Asia, corporate governance was a phrase that was hardly heard before 1997. It became very prominent after the East Asian financial crisis, not only for Indonesia, South Korea and Thailand, but for all of us in the region. It was quite clear that some of the major reasons for the East Asian financial crisis could be traced to corporate governance issues.

Prior to the Enron scandal, there was quite a lot of preaching coming from the United States and Europe as to the importance of corporate governance. Our initial reaction was that this is one of those Anglo-Saxon phrases that they foist on us in East Asia and use as the reason for advocating quite a lot of reforms. Since we are very pragmatic, however, we looked at the numbers and we looked at the issues and we were convinced that,

Frank Wiebe

Chief Economist and Director,
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yes, we had to undertake very serious corporate governance reforms.

As a consequence of 1997, in nine of the ten East Asian economies, Institutes of Directors were either established or strengthened. What do the Institutes of Directors do? We try to promote corporate governance reforms in our respective economies, but also we have tried to bind ourselves together to cooperate, in terms of writing cases of both corporate governance failures and a few successes to illustrate the importance of these principles. As a consequence, we have been doing quite a lot of joint training programs, using this as a learning technique, to take advantage of expertise that is very limited and widely dispersed through the region. We've done this mainly with support from the OECD and the World Bank.

We also confronted this whole issue of corporate governance being an Anglo-Saxon imposition on East Asia. We looked at the issues and decided that instead of letting the United States dictate what should be done, we would show that we're concerned enough about the problem to be formulating guidelines for good corporate governance practices. We felt it was also necessary to take into account the actual situation in East Asia where conditions are very different from the West. To highlight one difference: in New York you have a very active stock exchange. A good deal of your corporate financing comes from capital markets. In many of our economies, however, capital markets are very underdeveloped. Much of the financing for corporations comes from financial institutions such as banks, and from taxation, not from the stock exchanges. So, when anyone talks to us about the importance of minority shareholders we nod our heads and agree that it is important, but point out that it is not as important as it is in the United States.

We agreed from the very start that we were going to follow global standards and the principles that have been advocated and formulated by the OECD . We recognized that as an ultimate objective. Meanwhile, there are many steps we are taking in that direction.

We formulated a set of guidelines for good corporate governance practices. We became ambitious about them and said, let's see how far we can sell these East Asian generated initiatives to APEC.

Four APEC economies expressed reservation. Can you guess which? The first was Australia. They said, 'Well, we are suspicious of any initiative that comes from East Asia without involving us.' New Zealand, Canada and the United States expressed similar reasoning. To be fair to them all, after they looked at our guidelines they did agree and so last October in Shanghai under the chairmanship of China, APEC endorsed the guidelines formulated by the East Asian economies.

We've also been working with important corporations. We have organized in each of our respective economies what we call a business sector advisory group including our top level CEOs who are committed to corporate governance. Again, all nine economies have agreed to establish individual national business sector advisory groups on corporate governance.

In 1999, we decided to establish the Institute of Corporate Directors, because I was convinced the only way out of the consequences of the East Asian financial crisis was for us to address the issue of corporate governance. It was not difficult because we had a president at that time who was a movie actor. There is nothing wrong with having a movie actor for a president except that this one created five different Enrons and there was a massive outflow of financial resources. Portfolio managers simply dropped the Philippines. The country fell off their radar screen and they dropped Philippine stocks completely. As a result, the stock exchange of Manila went down dramatically. Of course, there was quite a lot of excitement and everybody was saying emphatically, "We need corporate governance reform." So, we did it.

Even during the tenure of this president, a very bad situation, which took us about a year to get rid of, we were able to pass two new pieces of legislation which were very important.

One was a change in our General Banking Act, which now requires the presence of independent directors in all banks. Second, we decided to strengthen our SEC because that was used as a playground by the president of the Philippines to benefit his friends and cronies.

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Chairman,
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in the Asia Pacific;
President and CEO,
Institute of Corporate Directors

We established the institute of corporate directors with three objectives; the first is to create a grass roots movement. The Philippines is an open society with a commitment to democracy. We do not have the types of problems that come when you have a lot of state enterprises. Much of business is in private hands and if you want to implement corporate governance reforms you've got to sell the idea to the people who run and own corporations.

The problem is, who are the guys who run the corporations? A friend of mine differentiates among three types of banks: white, yellow and brown. White would be foreign banks that are operating in your country. Yellow are the Chinese Filipinos, who have been there for some time, and control quite a lot of enterprises. They have their own, slightly different business practices. The brown would be the native Filipinos.

My impression is that there is no real difference between brown and yellow. We belong more or less to the same business culture; that culture is, that if you are the chairman and owner, you behave like a Chinese emperor—no questions are asked, you rule absolutely and you do with the company as you please. That's an exaggeration, but it is a situation that we are confronted with and, therefore, to reform corporate governance you have to change the mindset of these people.

Due to the change in banking legislation, our central bank requires all bank directors to go through training in corporate governance. Not even the United States has done this. If you fail to meet this requirement, you cannot continue to serve on the board of any bank. We're doing that also with government-owned and controlled corporations and eventually we'll be doing that for publicly-listed companies.

We are also doing policy advocacy. The Philippines had no document on corporate governance until 1997. The first was a listing of the duties and responsibilities of bank directors issued by the Central Bank of the Philippines. Even now, we do not have a single document which says, the Philippines is committed to corporate governance reform. That gap will be filled in the next few days, because we've prepared an executive order expressing that commitment.

In addition, we've played an important role in crafting the guidelines for proper corporate governance practices in APEC. The Philippine government is the first APEC economy to adopt those guidelines voluntarily.

We now have a framework code for corporate governance. We also have a code for proper practices of directors adopted by the Philippine government. There was a World Bank review of standards and codes in corporate governance in the Philippines. They found there was nothing very much wrong with our laws, but that everything was wrong with respect to the implementation and observance of those laws. We've gotten all their recommendations and put them into a three year program of corporate governance reform and the Philippine government has adopted that program officially.

So, not only have we been doing directors' training, which is very grass roots, but we've been seriously advocating corporate governance reform with the government to a point where this has become a requirement for banks, government-owned and controlled corporations, and eventually, for publicly listed companies.

Lastly, we decided that the only way that we can move forward quickly in any reform in the Philippines is to enlist the support of our neighbors. We are saying to our politicians and regulators that, "Hey, Singapore is doing this, Hong Kong is doing this, and Malaysia is doing this and to become competitive we've got to do this, too!" We've been very active in regional networking and that's why we've been working with other Institutes of Directors in East Asia. We have launched a network among these institutes and also among the business center advisory groups.

HASUNG JANG

Professor of Finance, Korea University; Chair, Participatory Economy Committee of the People's Solidarity for Participatory Democracy.

When I travel around Asia, I get angry because each country has good natural resources, hard-working, highly educated people full of ambition and potential, but they are not doing well because of a lack of leadership in business and politics and in dealing with corruption. I believe improving corporate governance is not just a business issue, but a social issue and a democratic issue in the region.

In the wake of the East Asian Financial Crisis, corporate governance has become almost a household word in Korea. There have been tremendous changes in laws and regulations. Now we have outside directors, which we never had before and there's a good understanding of what the concept means. In some cases, outside directors are taking active roles in protecting not only the minority shareholders' interests but also other stakeholders. We have significantly improved disclosure and accounting standards although we still have many problems in that area.

In the area of capital markets, minority shareholders' rights have been greatly improved at least on the books, and some of these rights have actually been exercised. I, personally, have filed a lawsuit against several companies. At the end of last month, we won $75 million against ten former and current executives of the top companies in Korea.

Although there are only a few cases, they are landmark cases, and we have also brought in more of this sort of freeing of the market while opening up to foreigners. We removed limits on how much foreigners can invest in each company which was restricted to around 14% before the crisis. Foreigners can now own any company up to 100%.

Foreign ownership now accounts for about 30% of all listed firms. Foreign ownership has also increased not only the value of the shares, but it has also increased pressure on the capital market to adopt a global standard in practicing in the areas of corporate governance. A hostile take over hasn't happened yet, but it is now an option, even for foreigners. We have also placed a lot of liability and responsibility on the shoulders of those controlling families of the big companies.

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Finally, we set up a financial supervisory agency similar to the SEC. This new agency has been very active in enforcing the new regulations although we still have a long way to go. Old habits cannot be changed overnight. The mindset of those who control the big companies hasn't altered—the chaebol family mindset hasn't changed nor has that of many of those in the establishment, political as well as business. Their resistance makes the government's job tougher and some of the new rules are not effectively enforced.

We let the big companies fail in 1997 and 1998, and so we thought we had cleared up the legacy of "too big to fail," but in recent years there have been some rollbacks. We let Hyundai Group live as it was before, despite knowing there were tons of problems to be solved.

Look at the top ten chaebol companies in Korea. The family, on average, owns only about 5%—really, they are minority shareholders. However, they utilize various means of entrenchment, such as pyramidal or circular ownership. While the family owns only 5%, they control niches up to 40%, which, I believe is a root cause of poor governance.

Let me talk about one of the cases in which I have been involved. I had to initiate a kind of derivative lawsuit against the world-class Korean company, Samsung Electronic. In September 1998, I filed a derivative lawsuit against the chairman of the group and ten other executives. It took us three and a half years to get a Court decision and finally the Korean Court acknowledged the minority shareholders' rights and they awarded us $72 million.

There were several cases involved in that lawsuit. One involved the illegal political contributions made by the chairman out of company money. Now we can retrieve about $5.6 million from the chairman's personal pocket. That sent a big signal, not just to the business community but also to the politicians. This week, the Korean business community announced officially that they're not going to raise political funds behind the scenes. I don't know whether they will keep their word but they cited that, "If we do so, Professor Jang will come in and file a lawsuit."

This long battle with the Court was very costly. It involved more than 5,000 pages of documents. Yet, after we got the Court's ruling there was a great deal of criticism targeted against us. Let me translate one column that showed up in a leading local newspaper. It starts, "I think the attack on the World Trade Center in New York City on September 11th of last year and the Korean District Court ruling on December 27th against the current and former executive of Samsung Electronic to pay 79.7 billion Won are fundamentally the same." It continues, referring to "outsider's invasion and destruction of the market economy and liberalism." The next paragraph argues, 'The Court ruling completed an anti-market revolution covertly and is symmetrical with a Stalinist ex-ante planning economy." Picking up on this column, the Bloomberg declares, "Stalin is alive and well and living in Seoul."

So you see, despite all the changes we brought in—the regulations, laws and all the systems in institutionalizing the markets—the mindset of those businessmen, controlling families and other social institutions clearly is still against these changes. More than a dozen columns in many newspapers have echoed the sentiments of the article I just read, attacking us as Socialists, Communists, or even Stalinists.

Even so, the East Asian region is making big progress. The problem is we started not from zero, but from minus thirty so although we have made huge progress, we are still barely above the water line, but I know we will continue to move forward.

DAOCHI TONG

Deputy Director General,
Listed Company Supervision,
China Securities Regulatory Commission

In the year 2000, we celebrated the ten year anniversary of the two stock exchanges: Shanghai and Shenzen. This year, we celebrate the tenth anniversary of the China Securities Regulatory Commission. You see how young the securities market is in China. Still, its speed of development has been quite impressive by many standards.

The total market cap at the end of 2001 is about 5.2 trillion Yuan. That's about 600 billion U.S. dollars. It's about half the size of China's GDP, or 1.23 trillion U.S. dollars. We now have about 1,160 listed firms in the two stock exchanges, about 110 securities houses and 15 fund management firms which manage 51 funds

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with total assets of 80 billion Yuan. There are also 100 solo practitioners and 65 million invested accounts. I say invested accounts rather than investors because there could be overlap between the two stock exchanges in opening accounts. In addition, we have 54 enterprises listed in Hong Kong shares and a few with dual listing status in New York and London.

The GDP has been growing quite fast for the past decade, with a 9% average rate of increase in gross GDP. We're talking about 7% GDP growth this year. While the development of the capital markets has paralleled that of the economy, there is still much room to develop the capital market, given the size of the savings of the population. The savings rate is about 40% of GDP. That's a potentially vast resource for the future development of the capital market.

The 65 million investors account for only 5% of the corporations, compared with 18% in Hong Kong, and about 49% in the U.S. So, there is still much room to develop in China. Plus, we entered into the World Trade Organization last year, which gave us a boost and I think will bring us more opportunities for securities market development, especially when the market is opened up to foreign institutional investors and intermediaries.

While I'm saying that we have great potential for growth, problems still remain and challenges lie ahead. These come mostly from the quality of listed firms and corporate governance.

As you know, most of the listed firms in China were transformed and restructured from state-owned enterprises. So they inherited the problems of the State-Owned Enterprises (SOEs). The State holds something like 54% of the total shares of listed firms. They are the largest, and in many cases, the controlling shareholder and sometimes take advantage of the minority shareholders. We always have a problem with the relationship between the listed company and the parent company, which is in many cases, a state-owned enterprise. There is an unclear separation between the two, which is often detrimental and injurious to minority shareholders.

Also, the board of most listed firms is still controlled by insiders. While they are mostly managers themselves, they are representative of the controlling shareholders. Few outsiders or independent, non-executive directors are on the board. That makes things difficult when you're trying to protect the interests of minority shareholders.

Another problem exists because managers are still mostly appointed by the government or the Party and there's a lack of incentive for them to perform.

Fortunately, the new chairman of the China Securities Regulatory Commission (who came into office in 2000) has made reform of corporate governance a strong priority of the CSRC. The first thing we tried to implement was the independent director system. The directive on independent directors requires each listed firm have at least two independent directors by June of this year and also have a third of their board consist of independent directors by June of 2003. This is a significant development because even in Hong Kong it is not a mandatory requirement to have one third of the board be independent.

We're also embarking on a program to train the candidates for independent directors because there is a shortage of personnel for that. We're conducting classes every month. These are always full and have about 300 persons, so there's quite a lot of activity going on in that regard.

In January, we issued the Code of Corporate Governance. It follows the principles of corporate governance of the OECD. However, it also takes into account the peculiarities of Chinese market conditions which the OECD did not really touch upon. We have, for example, a much more concentrated ownership structure, as is also probably true in Korea and the Philippines.

In the code, we talk about the protection of investor or shareholder rights. We are advocating firms adopt proxy voting and accumulative voting for the selection of directors. We are asking each firm to establish subcommittees on its board, including the bargaining committee, the remuneration, and the nomination committees, where independent directors should take the lead.

Regarding information disclosure, we have also made significant progress. Our regulations are quite close to international standards, requiring each listed firm to disclose the published, audited annual report; the audited half-year report; and the unaudited, quarterly report (which even the Hong Kong exchange does not require). Firms must disclose the controlling shareholders' interest and information. In a lot of cases the person who actually controls the company is unclear. You may know their names, but not know which is the controlling shareholder. We require firms to disclose that.

We are stepping up enforcement as well. We have regular checks for each listed firm. Last year we checked about 300 firms for our regular check on firms' use of corporate governance information disclosure. We also have special checks when a company has a special problem. We're working with the minister of public security to bring forward criminal cases of violations of security laws and regulations. We're working with other legal enforcement agencies to try and improve corporate governance, as well.

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DISCUSSION

PATRICK: In most of these countries the family-owned conglomerate controls groups of companies and their interactions. That makes for a much more complex and difficult corporate governance system. How are Korea and the Philippines addressing this?

ESTANISLAO: My answer to you is based on business structure. I indicated that much of our corporate financing comes from the banks and so we decided to give them priority. Now, banks are required by the international rules of the BIS to have capital adequacy ratios. These are related to risk weightings and if you introduce corporate governance into the risk weighting of the portfolios that banks have, then you can use the banks as your instruments to begin influencing the corporations they lend money to, whether they're directly, closely, or distantly related. That's what we're doing in the Philippines. We're getting very tough with the banks and since they have no choice but to be very transparent in their accounts, we're squeezing them with respect to corporate governance.

I'm quite optimistic. We have a central bank that is committed to corporate governance reform. We have banks that are very conscious of their reputational risk and so we're making some headway there. In addition, in the listing requirements for the Philippines stock exchange, until very recently, they could trade in the exchange as little as 10–20% equity shares. Within one year we'd like to have a minimum of 20% and we would like to keep pushing it, eventually, to 40%. We'll have to do this very gradually because, quite frankly, we do not understand the total impact, but we think that if it were 40%, that would be some check on whomever is controlling the remainder.

JANG: This is a tough issue for Korea and other Asian countries—the ownership structure is embedded in the system. We have tried several things. The government has banned closed ownership, where, "you own me and I own you." Many businesses have circumvented the regulation by using circular ownership, where, "A invests in B, B invests in C, and C invests back in A." If you are dealing with three companies, that structure is very simple, but if you take more than 60 and try to figure out who really owns whom, it is a real task. I don't see any practical ways to implement change in these complicated ownership structures, other than simply forcing them to restructure.

One policy we've tried is to put a cap on how much each company can invest into other affiliated companies. For example, you can invest only up to 25% of net asset value. The business groups are resisting this.

Before the crisis in 1997, the proportion of companies that were family-owned was about 9.5% and the affiliated company-owned companies were about 30%. After deregulation, family ownership decreased to 4.3%. However, affiliate companies' ownership actually increased to 40%. So, it's a real tough issue.

TONG: When the firms get listed, they have become a corporation first—have shareholder meetings, a board of directors, and so forth. Of course, these corporations are factories, and they need to be restructured first, and the problem with restructuring is, not all the assets can be listed because there are a lot of bad assets in the parent company. So, the new idea is to list at least part of the firm so they get good assets listed. They leave the bad assets in the parent company. Then the parent comes back and says, 'Hey, we gave good children to you. You have to give us back money.' That's what happens when you do the IPO and raise funds on the capital market.

That's why we have strong regulations to try to separate the two and ask that listed firms be independent. One way to do that is to ask the listed firms to either take over parent companies, to merge their relations, and ask the parent companies to dismantle—they have social assets, such as hospitals and schools. Through that method, we hope to get rid of the problem.

Q: In each of these countries, one of the key problems is the high benefits of private control that the families or controlling shareholders have in their relationship with the firm. Do you think there's any role for executive compensation arrangements, stock options, or other methods to better align the incentives of management with the shareholders? Or, is that a typical American style solution to this problem that wouldn't work in Asia?

ESTANISLAO: Unfortunately, the facts are not known in virtually all of East Asia. My friends in Hong Kong have started to take that first step. They've done research on the difference between companies that are controlled totally by families and those that are not. They look at the differences in terms of dividend pay-outs, for example. Of course, they realize that the dividend pay out ratios for family-owned corporations are very, very low, but when they started looking at the compensation structure that's where all the benefits work.

In the Philippines, we have an SEC regulation which requires you to disclose how much your directors and senior officers are paying on an aggregate basis. We are unable to push politically for individual reporting of compensation because of the threat of kidnapping. Our businessmen say, 'Well, if you put how much I receive, I'll be a target for the kidnappers.' That, of course, has been a very powerful argument. My view is that there is a limit to what you can do in terms of corporate governance unless you begin worrying about all of these other issues of national governance.

JANG: In the case of Korea, management is severely underpaid compared to the U.S. and other countries, mainly because everything is under family control. Managers should be paid more. In one case that I have been targeting in terms of shareholder activism, I proposed a stock option for executives in return for accepting some changes in corporate governance. I told them, 'I want to make you rich. Real rich!' Unfortunately, they haven't been in a position to take me up on this, but that is changing, if only in limited cases. Some companies bring real stock option schemes to executives to give them incentive to work on increasing share value.

One prominent case is that of a bank chairman who really stood above everyone else in the market. He got one Korean Won, (which is less than a cent)

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—Jesus Estanislao

My lawyers work so hard and so long, and even though they got landmark cases with over $70 million awarded, they were paid nothing. They got some kind words from me and a very light lunch as a compliment for their work over three years.

—Daochi Tong

for his annual salary and a huge number of stock options. He worked really hard to push up his share value and made a fortune. His example shows where we're heading, although it's not widespread yet.

TONG: This is a very important issue in China. There is no real link yet between executive compensation and the performance of companies.

There are two issues I want to raise; the first is the executive has too high an in cap benefit. Secondly, their compensation is not transparent—they have housing, they have cars, of which often we are not even aware. This they have inherited from the SOEs. Net income is really low compared to international standards.

We have perhaps eight firms listed in Hong Kong that have two salary systems. One shows investors a match to international standards, but what they really get is very, very low. We, like the Koreans, also need to raise payments to executives and we need to monetize them. Now, we're asking firms to disclose exact compensation in the annual report.

We have a whole chapter in our code about incentives, asking firms to establish such schemes. However, for stock options to work, we probably need to go step-by-step, because you need to have a strong link between the stock performance and the company performance. That's not the case here in China where we have market manipulation.

Q: Who are the domestic non-state agents of corporate governance in your economies? I was intrigued by the example from the Philippines, that the regulator is using banks as its agent to impose corporate governance on firms. Do the banks have their own incentives to be agents of corporate governance?

ESTANISLAO: With reference to the banks, my general answer is that there is very little leverage, so why not use what you have? If you can use the regulators, use them. Know, however, that they have limits to how far they can go. If you can use markets, do so. We are trying to develop corporate governance score cards so that the markets, themselves, will be the ones to rate the corporations, but this is a new target. Civil society groups, such as the Institutes of Corporate Directors, can also act as corporate regulators, organizing a minority shareholders association. We are now doing this and it is being promoted by the regulators themselves.

Use all your tools of leverage for as long as they are usable and go as far with them as possible, but then create new mechanisms so that you do not depend entirely on the regulators.

TONG: We don't have many non-State actors. The State media has played an important role in disclosing the bad practices of many companies. I think the Internet, too, really helps. When you have one news organization, people use the Internet to circulate information to investors.

We're trying to establish investor protection funds so that investors can sue a company or its directors and use the fund for legal assistance. In September, the Supreme Court first issued a decision that they were not going to accept any lawsuits as yet, but then reversed it. They say, if the CSRC makes the judgment that this is a forced disclosure case, then they will accept it. Of course, that puts us in the front line. It's hard for us to punish a company, because then they'll be sued, but at least it was a step forward, allowing investors to protect themselves through legal means of assistance. I think the Supreme Court will go further later, but at this stage, they're doing what they can.

JANG: The institutional investors can take a very decisive role if their vested interest hinges upon this corporate governance issue. In most cases, they take a very passive position but when some big hit is coming they will take a stance. So, in the extreme case, I think the institution can be a very big factor in changing corporate governance in the area.

Another way is through legal action. That's one reason I have been campaigning for class action suits in Korea. My lawyers work so hard and so long, and even though they got landmark cases with over $70 million awarded, they were paid nothing. They got some kind words from me and a very light lunch as a compliment for their work over three years. Let's give incentives an opportunity in the hands of those who lose money because of this poor corporate governance. In the future, we may have to worry about too many lawsuits, but let's worry about that later.

Q: Is there any private action or derivative lawsuit in China to allow the shareholders to sue the directors or officers directly? Also, if on paper these executives' compensation is something like $400 a month, they're going to say, "There's no way that you can get a $7 million award like in Korea." What's the incentive for these shareholders to sue?

Secondly, regarding the independent directors' training you are conducting—how are these candidates selected? How do you ensure they are not in any way affiliated with or influenced by the government or by the executives of the company?

TONG: Regarding enforcement, we just started a lawsuit regarding class actions or derivative issues. It takes a while for the Supreme Court to accept such things. You are correct. If the punishments are paid by the firm, and thus, eventually paid by the shareholders, then the shareholder will have no incentive to sue. Asking each executive to buy insurance would make compensation easier.

Regarding the independence of directors, we're open to society for training, but we have a strict selection process. They must be nominated by the shareholders or the nominations committee, elected by the board, and finally be approved at the general shareholders meeting. Before they're reported to the general shareholder meeting they submit their names and a biography to us to get approval because we need to see whether they're independent or not. So, we have a say in determining whether they can be independent.

PATRICK: It impresses me is that in corporate governance everyone faces the same general set of problems, but each country has its own approach to deal with them. One of the things I've appreciated from today's panel is that we have three quite different national experiences.

We heard words like "cronyism" and "market manipulation" and many other problems that exist in these economies, some of which are directly related to corporate governance, some of which are broader societal issues, such as kidnapping in the Philippines. It's appropriate that we've been hearing about the positive side. These are much better conditions now than existed three or four years ago. My guess is they will continue to improve over the next three to ten years, precisely because we have people like our panelists who are taking the initiative.

Use all your tools of leverage for as long as they are usable and go as far with them as possible, but then create new mechanisms so that you do not depend entirely on the regulators.

—Jesus Estanislao

Hugh Patrick
Jesus Estanislao
Hasung Jang
Left to right

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